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The Economist

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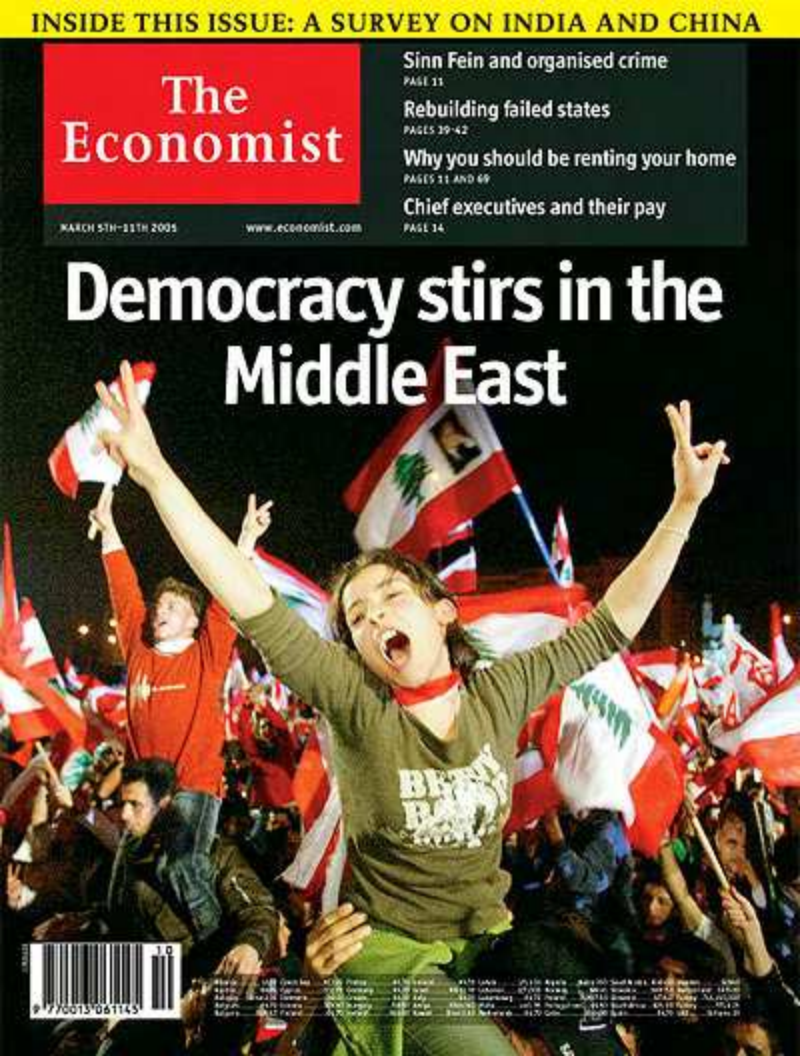

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Politics this week

Mar 3rd 2005
From The Economist print edition

Stirrings of democracy

AP

After tens of thousands of **Lebanese** from across the sectarian spectrum had taken to the streets of Beirut in protest against Syria's continuing control of their country, their pro-Syrian government resigned and Syria's president, Bashir Assad, said he would withdraw all Syrian troops “maybe within a few months”.

See article

In an apparent gesture to the Americans, who have been squeezing the regime, Syria's government handed over a **half-brother of Saddam Hussein**, Sabawi Ibrahim al-Hassan, to the Iraqi authorities, along with 29 other Baathist fugitives.

At least 122 **Iraqis**, mostly Shia Arabs, were killed by a suicide bomb—the highest number to die in any one incident since the fall of Saddam Hussein—in Hilla, south of Baghdad.

At a conference in London, the new **Palestinian** leader, Mahmoud Abbas (aka Abu Mazen), was assured by Britain's Tony Blair, the American secretary of state, Condoleezza Rice, and other leaders that his Palestinian Authority would be given masses of help to improve the fledgling state's economy, institutions and security. Mr Abbas condemned a Palestinian suicide-attack on a nightclub in Tel Aviv that killed five people, including the bomber.

President Hosni Mubarak, who has ruled **Egypt** for 24 years, said he would support a constitutional amendment to allow his candidacy for re-election later this year to be contested. But his own ruling party would still, in effect, be able to block an opponent.

International inspectors questioned key elements in **Iran's** nuclear story. Reports that Iran failed to mention (until confronted with evidence) a 1987 offer from A.Q. Khan, the father of Pakistan's bomb, to help with bomb-usable technologies added to suspicions that its efforts were not as peaceful as claimed.

After nine UN soldiers were killed in eastern **Congo**, the peacekeepers struck back, killing at least 50 of the militiamen that made the attack.

Tinkering with the future

France's National Assembly approved a constitutional change to allow for a referendum on the **European Union's constitutional treaty**. Denmark set a date of September 27th for its referendum.

Thierry Breton, boss of France Telecom, took over as **French finance minister**, replacing Hervé

Gaymard, who resigned after a scandal over his taxpayer-financed flat. The new head of France Telecom will be Didier Lombard.

See article

Saajid Badat was convicted in **Britain** of plotting to blow up an airliner using a shoe bomb, a device almost identical to the one used by Richard Reid, the British shoe-bomber caught trying to blow up a plane en route to the United States in December 2001.

Pope John Paul II resumed some of his duties after a throat operation to improve his breathing. But he may miss some Easter celebrations for the first time in his papacy.

A welcome reprieve

In a dramatic reversal of its ruling 16 years ago, America's Supreme Court abolished the **death penalty** for juveniles aged under 18 at the time they committed their crimes. This means a reprieve for the 72 juvenile offenders on death row.

See article

President Bush's anti-terrorist policies suffered another blow when a federal judge ordered the administration to charge an American "**enemy combatant**" with a crime or release him within 45 days. José Padilla, suspected of planning to explode a radioactive bomb, has been detained in a military brig in South Carolina without charge or access to a lawyer for three years.

See article

A lawsuit against the treasurer of a political committee formed by Tom DeLay, the House majority leader, went to trial in **Texas**. Five Democrats allege that Bill Ceverha failed to report corporate donations to the state's ethics commission during the 2002 mid-term elections.

An ill wind

Hong Kong's chief executive, Tung Chee-hwa, was reported to be about to step down from the office he was appointed to by China when Britain withdrew in 1997. His departure, officially for health reasons, was welcomed by pro-democracy groups.

See article

An Indonesian court sentenced a Muslim cleric, **Abu Bakar Basyir**, to two-and-a-half years in prison for his part in the 2002 Bali bombing.

At least 70 Maoist rebels were killed in clashes with troops in **Nepal**. It was the deadliest fighting since King Gyanendra seized power last month.

A four-month amnesty for illegal workers in **Malaysia** (under which they would have to leave the country but with good hopes of returning) expired. The authorities promptly began a crackdown on the estimated 500,000 mostly Indonesian workers who did not take advantage of the deal.

AFP

See article

Opposition groups in **Tajikistan** protested at the result of the parliamentary election that handed 80% of the votes to the president's ruling Popular Democratic Party.

Kirgizstan's parliamentary election had no conclusive result. There will be a second round of voting for more than half the seats on March 13th.

Criticism in the American State Department's annual report on **human rights** angered China, which accused America of double standards. The report also found human-rights abuses by allies, such as Saudi Arabia, and Iraq's interim government.

Debtor's delight

Argentina's president, Néstor Kirchner, declared that his country had left its 2001 debt default behind. He said that “at least 70-75%” of bondholders had opted to take part in the government's tough restructuring plan, which gives creditors around 35 cents on the dollar.

See article

AFP

In **Uruguay**, a left-winger, Tabaré Vázquez, took office as president, in another sign of Latin America's leftward trend. Like Brazil's Lula, Mr Vázquez is expected to pursue a pragmatic economic policy.

See article

Carlos Ortega, a fugitive **Venezuelan** labour leader who led a failed two-month general strike against the government of Hugo Chávez in 2002-03, was arrested while playing bingo in Caracas. He faces charges of treason.

Mexico's foreign minister said his country would take legal action in the American courts against an Arizona-based pressure group's plan to organise citizens' patrols to prevent illegal immigrants crossing the border into the United States.

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Business this week

Mar 3rd 2005
From The Economist print edition

Big shop

Federated Department Stores, which owns Macy's and Bloomingdale's, laid out a $17 billion plan to acquire **May Department Stores**. The deal doubles the size of Federated, and will create a mammoth retailer with annual sales of $30 billion. Federated hopes the merger will help it compete with speciality shops, such as Gap, and large general retailers.

Costco, a wholesale operator synonymous with giant warehouses selling direct to consumers, posted a net profit for the three months to February 13th of $305.5m, a 35% increase on the same period in the previous year.

InBev, a Belgian beermaker formed by the merger of Interbrew and AmBev, a Brazilian beermaker, announced a 56% rise in pre-tax profits for 2004 to *euro*1.16 billion ($1.5 billion). The company, which produces Becks and Stella Artois and is the world's largest beer brewer by volume, said strong sales in Brazil had helped drive its profit.

Biogen Idec and **Elan**, two biotech companies, saw their share prices collapse (by 40% and 70% respectively) after withdrawing Tysabri, a drug that treats multiple sclerosis. Tysabri has been associated with two cases (including one death) of a rare and devastating disease of the central nervous system.

Energy for the future

Royal Dutch/Shell signed a deal with Qatar's state-owned gas company for a 30% stake in a $7 billion project that will eventually provide **liquefied natural gas** to Europe and America, starting in 2010.

Exxon Mobil sold its 3.7% stake in **China Petroleum & Chemical (Sinopec)**, Asia's largest oil refiner. Exxon bought the stake in 2000 to establish its presence in China. It now has 600 petrol stations in Fujian province.

Britain awarded a consortium headed by **EADS** (the European Aeronautic Defence and Space company) “preferred bidder” status for a £13 billion ($25 billion) contract to build aircraft-refuelling systems for the Royal Air Force. The decision is a blow to Boeing (which has a virtual monopoly in the market) and BAE Systems, which had presented a rival joint bid.

Verizon said it would give **MCI** two weeks to consider a rival takeover bid from **Qwest**. Qwest revised its offer to buy MCI to include a faster cash payout, although at $8 billion the value of the deal remains the same. Meanwhile, MCI reported a fourth-quarter net loss of $32m; the telecom company expects revenue in 2005 to fall by up to 14%.

Clear Channel Communications, America's largest radio-station owner, posted a fourth-quarter

loss of $4.7 billion, caused by a $4.9 billion write-off of the value of radio licences. The news followed hard on the heels of Viacom's announcement of its $18.4 billion fourth-quarter loss. Analysts deliberated on the radio industry's ability to compete with internet and satellite providers of music.

Currency markets

Apax, a private-equity group, bought a 63% stake in **Travelex**, the world's largest non-bank provider of foreign exchange. Valued at £1.1 billion ($2.1 billion), Travelex's main business is servicing foreign-exchange payments for companies. It also operates foreign-exchange desks at many airports and travel agents.

After a chorus of complaints, America's **Securities and Exchange Commission** agreed to delay the imposition of strict new rules governing internal accounting controls by a year, but only for small listed firms and foreign companies whose shares are traded in the United States.

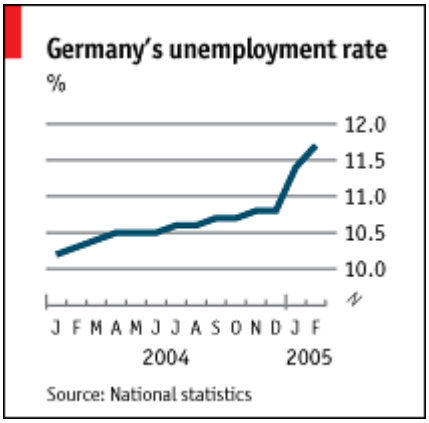
Marsh & McLennan posted its first quarterly loss since 1997. The world's largest insurance broker reported a loss of $676m in the fourth quarter compared with a profit of $375m a year earlier. The firm's share price fell in October after investigations began into charges that the company rigged bids and acted against clients' interests.

HSBC, a big bank, saw net profit for 2004 rise by 35% to $11.8 billion. Revenue increased to $50.6 billion.

In the biggest alleged case of **tax fraud** by an individual in American history, Walter Anderson (also known as Mark Roth) was charged with evading $200m in tax and hiding almost $500m in offshore accounts. Mr Anderson, an entrepreneur and art collector who made his money in telecoms, denies the charges.

More reform needed

The unemployment rate in **Germany** rose again, to 11.7% in February; 5.2m people are now out of work. The OECD, in a report on economic development in rich countries, urged Germany to reduce its payroll taxes, among the highest in Europe, as a means of stimulating jobs. Meanwhile, the IMF cut its 2005 growth forecast for Germany to 0.8% (from 1.8% last autumn).



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The Middle East

Democracy stirs in the Middle East

Mar 3rd 2005
From The Economist print edition

America's detractors are having to admit that its often clodhopping policies may be starting to work

AFP

Get article background

IT HAS been an extraordinarily hopeful few weeks in the habitually dank and depressing politics of the Middle East. In the wake of an unprecedented general election in Iraq and an admirably genuine presidential one in Palestine, tens of thousands of Lebanese people, from a kaleidoscope of religious groups, have been marching together on the streets of their capital, Beirut, calling for democracy and the removal of their anti-democratic occupiers, the Syrians. Syria's government is plainly nonplussed by this outburst of people power (see article) and may even risk losing its clammy grip back home. No less astonishingly, Egypt's ruling autocrat, Hosni Mubarak, after some 24 years in unfettered control, suddenly felt obliged to announce that he would allow the opposition, albeit a sanitised version of it, to put up a candidate (or more) against him when he faces re-election later this year. No less strikingly, modest but notable steps towards democracy have recently been taken in the heart of Arab despotism, Saudi Arabia, where multi-candidate (though non-party) elections for local government took place last month. The Saudi foreign minister this week promised that next time round, yes, even women would be able to vote and run for office.

What is going on? For America's leaders it is proof that their relentless trumpeting of the virtues of democracy as a chief weapon in the war against terror is right. To President George Bush's delight, a number of prominent Arabs have begun to admit as much. Some have likened the impact on them of Iraq's election to the impact in Europe of the fall of the Berlin wall in 1989. However much Arabs resent America's intervention in Iraq—and most still do—the election there, a month ago, has plainly struck a chord across the region. Without a doubt, something exciting is in the air. Democracy for Arabs can no longer to be dismissed as the stuff of foolish dreamers.

Not so smug, you neo-cons

So is it on an unstoppable roll that will lead to peace and democracy across the region? Absolutely not—at any rate, not yet. The Middle East is still a dangerous mess. The despots are not becoming democrats overnight, and the Americans know it is risky to promote ideas that threaten the regimes of some of their closest yet far from democratic allies in the wider region, such as Pakistan, Egypt, Jordan and Saudi Arabia.

Iraq, for another thing, could still go horribly wrong. The blood still flows apace, with a suicide-

bomb this week killing more people (at least 120) in a single blow than any previous atrocity since the Americans toppled Saddam Hussein. It will be several months before it becomes clear whether a broad-based, more legitimate government, with luck including a good number of Sunnis whose constituents refused or were afraid to vote in the poll, can start squelching the insurgency. The risk of sectarian fragmentation and civil war still exists.

The Middle East's other hitherto trickiest conundrum—how to embed Israel and Palestine side by side as two secure states—is still far from solved, pouring poison into America's relations with swathes of the Arab and Muslim world. The death of Yasser Arafat and the emergence of a more practical Palestinian leader in the person of Mahmoud Abbas (Abu Mazen) have helped bring about a much-desired but still-fragile ceasefire, and a fresh burst of hope that the two sides can accommodate each other. But although Israel's bulldozer of a prime minister, Ariel Sharon, seems likely to ensure that Israel's settlers and soldiers vacate the Gaza strip (the smaller of the two bits of an emergent Palestinian state) by the autumn, the much harder problems of agreeing to Palestine's borders, dealing with Palestinian refugees and sharing Jerusalem—over which many previous efforts to solve the conflict have foundered—have yet to be tackled.

Nor is the puzzle of Iran and its nuclear ambitions close to a solution. Iran is very much a piece of the Middle East's peace-and-democracy jigsaw. It is Syria's last friend in the area. It has leverage over Hizbullah, the Lebanese Shia group that still seeks to stir up hatred in Israel-Palestine, despite the ceasefire. And Iran is the sole country in the region that refuses to accept Israel's existence. Following his recent tour of Europe, Mr Bush sounds readier to bolster European efforts to stop the mullahs, with a mix of incentives, intrusive verification and the threat of sanctions, from building a bomb. If a “grand bargain” were struck between America, Europe and Iran, with a verifiable renunciation by the mullahs of their military nuclear plans, it would help towards peace in Israel-Palestine too. But the chances of striking such a bargain are no better than even.

So what next?

Despite the apparent vindication of America's pro-democracy policy, Mr Bush must still tread warily: it is for Arabs to democratise, not for Americans—despite the example of Iraq—to impose their ideas by force. Yet Arab rulers must realise, as many of them now seem reluctantly ready to do, that they cannot remain deaf to the democracy call. With more and more of their people watching their Lebanese, Palestinian and Iraqi brothers on the street and at the polling station, the era of despotic stagnation is steadily drawing to an end.

The Europeans, with the French and Germans to the fore, have been gracelessly loth to admit that the Bush doctrine, however crassly simplistic in expression and implementation, has moved the scenery—in the right direction. As a token of recognition, they should certainly offer heartier help in Iraq.

Now is the biggest chance for many years to lance the Israel-Palestine boil. Neither Americans nor Europeans can sit on their hands while waiting for Israel to leave Gaza and freeze its settlement building elsewhere or for the Palestinians to corral their militants; and neither Palestinians nor Israelis can be allowed to play the “after you” game. This week's Palestinian confidence-building and money-begging conference in London was only a start. With democracy stirring across the region, imagine what a boost it would get—and what a shot in the arm for the still mistrusted Americans—if Israelis and Palestinians settled their differences at last. It is a prospect almost too wonderful to contemplate. But it is no longer ridiculous.

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Economist.com OPINION

India and China

The tiger in front

Mar 3rd 2005
From The Economist print edition

It is good that India is starting to see China less as a threat than as an inspiration

WERE it not for two things, India's economic performance would seem remarkable. Since beginning to dismantle the "licence raj" and open up to the global economy in 1991, the country has achieved average annual economic growth of about 6%. The proportion of people living below the poverty line, one-half in 1978, fell to one-quarter by 2000. Since 1991, average GDP per head, adjusted for purchasing power, has doubled. India, its finance minister, Palaniappan Chidambaram, felt able to boast in his budget speech on February 28th, "is not a poor country." "Yet," he went on, "a significant proportion of our people are poor." That is one of the things thwarting self-congratulation: India's poor number more than 260m and, as Mr Chidambaram noted, nearly half of its children under four are underweight.

The second thing is China. Comparisons are unavoidable. The two countries, sharing a 3,500km (2,170 mile) border, are unique in each being home to more than one billion people, many of them poor. Other Asian "tigers"—Singapore, Taiwan, Hong Kong, Malaysia, even South Korea and Thailand—are relatively small places, whose experience it was possible to dismiss as largely irrelevant. China, however, proves that size is no obstacle to tigerish growth. And as our survey comparing India and China shows, China has done better than India on virtually every measure of economic growth and poverty reduction. A growth rate of 6% seems solid, but melts beside one of close to 10%.

The other path

Mr Chidambaram and some of his colleagues are painfully aware of the "Chinese model". In his budget speech, Mr Chidambaram described a recent meeting of finance ministers. He said his Chinese counterpart had looked at him as he told the meeting that China had received $500 billion in foreign investment since 1980. Well might he look: India has received less than a tenth of that.

India's problem is broader, in fact: it lacks investment of all kinds. By local standards, an investment boom is under way, but India is still investing about only about one-quarter of GDP. In China, with a GDP about two-and-a-half times as big, the ratio is more than 40%. The gap shows, especially in infrastructure such as roads, sea- and airports, and electricity supply. There are two main obstacles to new investment: regulations that deter business; and a fiscal deficit, of around 10% of GDP, that leaves little scope for public spending.

This budget was a test of whether Manmohan Singh's Congress Party-led government, which surprised even itself by winning last year's election, would confront these challenges. It half-

passed (see article). The government has lifted some of the rules “reserving” the production of some goods for small firms. It has lavished more money on infrastructure, education and health care. And it has made some progress in simplifying India's tax system. The finance minister knows that the key to raising central-government tax revenue is not raising rates, but getting more people to pay taxes. And the planned introduction, this April, of a nationwide value-added tax levied by India's state governments is, if China's experience in the 1990s is a guide, another hopeful measure. In other areas, though—measures to spur foreign investment, curbs of wasteful subsidies, further privatisation—the budget fell short.

Indian commentators mostly judged it a clever balance of the need for reform and political reality. Last year's general election was widely, if inaccurately, seen as a kick in the teeth for liberalising reforms from the poor rural majority. Moreover, Mr Singh's Congress party rules in coalition with a number of smaller parties, and relies on the “outside support” of the Communists, who routinely oppose most reforms, notably to India's labour laws, which are one of the biggest deterrents to investment. This, goes a common refrain, is why India can never be like China: there the Communists (their Indian counterparts gloss over the paradox) are free to reform without the hassle of competitive politics.

Voters are such a nuisance

The perennial question in the political economy of development is posed in the starkest way by the contrasting experiences of India and China: is democracy good for growth or not? There is no simple answer. It all depends.

China has achieved staggering growth under a liberalising but still tyrannical regime. Reminders of just how far the country has to go in this regard arrive with dismaying regularity. This week China arranged the removal of Tung Chee-hwa as chief executive of Hong Kong—a popular decision, as it happens, but one whose execution makes a mockery of democratic process (see article). China is also poised to pass an “anti-secession law” directed at Taiwan, whose people yearn for freedom from such intimidation. Sadly, China shows that a vicious, backward, human-rights-abusing dictatorship can perfectly well lead a very poor country out of poverty.

But this is certainly not to say that vicious, backward, human-rights-abusing dictatorships are in general good for growth. As a rule, they are not: look at Africa. China, though an extraordinarily important exception, is still just that: an exception. Equally, democracy is not necessarily bad for economic development. India, after all, whose performance is disappointing only by Chinese standards, proves as much. Democracy has taken root in many countries in Asia and Latin America, including some which had been growing pretty well before: progress has not slowed in those places as a result. Democratic backing for economic reform can be mobilised. When that has been done, the prospect of continued political and economic stability is more secure.

But the main point is this: democracy is not valuable only or mainly because of the contribution it may make to development. It is a great good in its own right. A proudly democratic India that grows at 6% a year (8%, which is entirely achievable, would be even better) should be congratulated for having succeeded better than a brutal anti-democratic China which grows at 10% a year. There is more to life than GDP.

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Economist.com OPINION

House prices

To buy or not to buy? That is the question

Mar 3rd 2005
From The Economist print edition

Today it is often much cheaper to rent than to buy a house

Getty Images

"IT IS always better to buy a house; paying rent is like pouring money down the drain." For years, such advice has encouraged people to borrow heavily to get on the property ladder as soon as possible. But is it still sound advice? House prices are currently at record levels in relation to rents in many parts of the world and it now often makes more financial sense—especially for first-time buyers—to rent instead.

Homebuyers tend to underestimate their costs. Once maintenance costs, insurance and property taxes are added to mortgage payments, total annual outgoings now easily exceed the cost of renting an equivalent property, even after taking account of tax breaks. Ah, but capital gains will more than make up for that, it is popularly argued. Over the past seven years, average house prices in America have risen by 65%, those in Britain, Spain, Australia and Ireland have more than doubled. But it is unrealistic to expect such gains to continue. Making the (optimistic) assumption that house prices instead rise in line with inflation, and including buying and selling costs, then over a period of seven years—the average time American owners stay in one house—our calculations show that you would generally be better off renting (see article).

Be warned, if you make such a bold claim at a dinner party, you will immediately be set upon. Paying rent is throwing money away, it will be argued. Much better to spend the money on a mortgage, and by so doing build up equity. The snag is that the typical first-time buyer keeps a house for less than five years, and during that time most mortgage payments go on interest, not on repaying the loan. And if prices fall, it could wipe out your equity. In any case, a renter can accumulate wealth by putting the money saved each year from the lower cost of renting into shares. These have, historically, yielded a higher return than housing. Putting all your money into a house also breaks the basic rule of prudent investing: diversify. And yes, it is true that a mortgage leverages the gains on your initial deposit on a house, but it also amplifies your losses if house prices fall.

"I want to have a place to call home," is a popular retort. Renting provides less long-term security and you cannot paint all the walls orange if you want to. Home ownership is an excellent personal goal, but it may not always make financial sense. The pride of "owning" your own home may quickly fade if you are saddled with a mortgage that costs much more than renting. Also, renting does have some advantages. Renters find it easier to move for job or family reasons.

"If I don't buy now, I'll never get on the property ladder" is a common cry from first-time buyers. If house prices continue to outpace wages, that is true. But it now looks unlikely. When prices get out of line with what first-timers can afford, as they are today, they always eventually fall in real

terms. The myth that buying is always better than renting grew out of the high inflation era of the 1970s and 1980s. First-time buyers then always ended up better off than renters, because inflation eroded the real value of mortgages even while it pushed up rents. Mortgage-interest tax relief was also worth more when inflation, and hence nominal interest rates, was high. With inflation now tamed, home ownership is far less attractive.

The divergence between rents and house prices is, of course, evidence of a housing bubble. Someday prices will fall relative to rents and wages. After they do, it will make sense to buy a home. Until they do, the smart money is on renting.

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Economist.com OPINION

Northern Ireland

A new offensive

Mar 3rd 2005
From The Economist print edition

How America can help prise the IRA away from its guns

AP

IT IS a curious feature of the Good Friday Agreement, the deal which got Northern Ireland's peace process under way, that while it proscribes a wide range of paramilitary activities, it does not mention organised crime—one of the IRA's main occupations. Perhaps this was an oversight on the part of the British and Irish governments. Perhaps they thought it so obvious that extortion, smuggling, armed robbery and fraud were unacceptable that it did not need to spell the point out to Sinn Fein, the IRA's political wing. Or perhaps they felt that organised crime was less important than the terrorism that the Good Friday Agreement was primarily aimed at stopping; and that to make too much of a fuss about the odd heist would undermine the peace process.

Whatever the reasons, the omission was a mistake. Organised crime is flourishing in Northern Ireland, and ignoring the IRA's involvement is likely to have hindered, rather than helped, the peace process: the principal sticking point has been the decommissioning of IRA weapons, and running a profitable sideline in bank robbery and extortion gives the IRA an extra reason to hold on to its guns. Now the Irish government is at last hitting the IRA's business empire in the south. This belated crackdown is welcome, for republicans cannot expect to be in government while running criminal gangs.

Competition focuses the mind wonderfully. One of the factors which seems to have led the British and Irish governments to hit out at the IRA's criminal activities is the electoral rise of Sinn Fein. In Northern Ireland, it is now the second-largest party, after the Democratic Unionist Party. In the republic, it got 3% of the vote in the 1997 national election, 8% in last year's local elections, and its share is expected to rise further.

Sinn Fein's wealth—“it's a very rich party,” says a British official—has therefore become a matter of growing interest to both governments, and so have the origins of that money. Organised crime, as the Independent Monitoring Committee that keeps tabs on paramilitary activity has pointed out, is flourishing: the IMC reckons that's because, since the ceasefire, paramilitaries have been finding new outlets for their energies. The bank robbery in December which is believed to have netted the IRA £26.5m was only the largest of a series of big operations last year the IMC says were carried out by the IRA.

The IRA's criminal activities are a problem in themselves, and are also impeding the peace process. They discourage the IRA from decommissioning its weapons and make it hard for British and Irish politicians to take seriously Sinn Fein leaders who, according to the Irish prime minister, Bertie Ahern, were planning that massive bank robbery at the same time as negotiating their

return to government in Northern Ireland.

All of which explains the recent assault by the Irish police on businesses suspected of being involved in laundering IRA money in the republic. This turns out, coincidentally, to be a good time to have a go at the IRA. A particularly vile murder of a Catholic in Belfast has led to accusations that the alleged perpetrators, IRA members, will go unpunished because witnesses are too scared to give evidence against them. Under immense pressure from the people who normally support it, the IRA has, extraordinarily, expelled three members. The five sisters of the victim, Robert McCartney, who are taking their campaign to America, say that's not enough: they want convictions. The IRA suddenly looks vulnerable in its heartland.

Home and abroad

America, whose moral sway in much of the world has shrunk as its power has grown, still has clout in Northern Ireland. It was no coincidence that the peace process gained new momentum after September 11th, when terrorism became a reality for Americans.

In practical terms, there isn't much America can do, since it is no longer a big source of republican funds. But the message it sends matters. That's why it is good that the White House is not inviting Sinn Fein's leaders to its annual St Patrick's Day bash on March 17th, the traditional venue for reaffirming American solidarity with Irish republicanism, and intends to welcome the McCartney sisters; and why Sinn Fein leaders should be refused fund-raising visas.

Unfortunately, the White House is not inviting other Northern Irish parties on St Patrick's Day either, on the grounds that singling out Sinn Fein would cause offence. That's feeble. A social snub is hardly too harsh a reprimand for colluding in organised crime. Offending Sinn Fein is exactly what America can most usefully do.

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Economist.com OPINION

Argentina's debt restructuring

Tough deal

Mar 3rd 2005
From The Economist print edition

Debtor governments should not conclude from Argentina that default is an easy option

AFP

Get article background

THE decline and collapse of Argentina's economy in 1998-2002 still arouses great passions, and not just among the people of that ill-starred country. No wonder. Argentina's chaotic default and devaluation, and its desperate efforts to stave these off, inflicted great hardship. By mid-2002, living standards had dropped by a fifth from their peak; unemployment soared to 21%. With hindsight, it is clear that the mistakes of many clever people—Argentine policy-makers, officials at the International Monetary Fund and America's Treasury, as well as the world's financiers—contributed to the debacle. Yet these passions risk clouding judgments over how Argentina should rebuild, and how the world should try to avoid a recurrence of such financial catastrophes.

That is especially so with regard to the country's debt. Recall that in December 2001 Argentina declared the world's biggest sovereign debt default (on bonds worth $81 billion). This week, Néstor Kirchner, Argentina's president, in a speech to Congress, claimed victory in his government's bruising campaign to force bondholders to accept a record write-down of their claims. The figures were not due to be released until after *The Economist* went to press. But Mr Kirchner said that “at least 70-75%” of bondholders have signed up to a deal that is worth around 35 cents on the dollar. Compare that with recent sovereign restructurings where creditors received twice that, and no wonder Mr Kirchner is crowing (see article).

Given that disparity, many argue that Argentina has got away with financial murder. The obvious worry is that other governments, especially in Latin America, may now conclude that default is a cheap option. If that happens, lenders would lose in the short run. But in the long run, Latin American countries would lose even more, as the cost of credit for all of them rose. Are these fears justified?

The answer has several parts. First, Argentina has hardly escaped scot-free. Its economy has bounced back strongly. Yet even with the temporary advantage of not servicing its bonds, from the moment of default Argentina has grown little more than Brazil, which continued honouring its debts. Four out of ten Argentines are poor, in what was once a middle-class country. Their banks and pension funds have been stuffed with low-yielding government paper.

Second, Argentina may not yet be out of the woods. In the other deals, more than 95% of bondholders signed up. Some of those who held out were, eventually, awarded their money in full by courts. Third, Argentina had less room to manoeuvre than some creditors claim. Even after the

deal, its public debt will stand at around 75% of GDP (compared with 52% in Brazil). Admittedly, Argentina's debt will now pay much less interest than Brazil's. But the government has, in effect, committed itself to a primary fiscal surplus of over 3% of GDP for the foreseeable future. Offering more might merely have heralded a fresh default a few years hence.

The bigger worry is Mr Kirchner's political grandstanding. His rants against the IMF, bondholders and privatised utilities may sway Latin America's public opinion. His rhetoric also does nothing to encourage investment. Meanwhile, the president has spurned a golden opportunity to push through the unpopular measures needed to turn recovery into sustained growth. These start with tariff rises for privatised utilities to unleash private investment in infrastructure and reforms of taxes and provincial finance. As the economy recovers, Mr Kirchner can hardly continue to claim a national emergency to ride roughshod over utility contracts.

Mr Kirchner still faces a battle with the IMF, to which Argentina owes $14 billion. An agreement to roll over some of this was suspended, pending the debt swap. In any new accord, the IMF is bound to insist on the structural reforms required to sustain growth. If Argentina is unwilling to stick to these conditions, the Fund should finally cease lending to its problem debtor—or risk even greater damage to its credibility.

Sharing the blame, and the pain

There are many lessons from this sorry saga. Small savers tempted by emerging-market bonds should realise that reward has risk attached. Most institutional investors got their money out of Argentina one way or another. Even so, they may not be so lucky next time. They would be wise to pick more carefully among emerging-market borrowers. The safe level of debt for emerging economies is lower than previously assumed. Lastly, it is wrong to imagine that default has become a painless route to prosperity. It has not.

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CEO pay

Fat cats turn to low fat

Mar 3rd 2005
From The Economist print edition

Bosses' bonuses are booming, but that is not all bad

Get article background

NOW is the season when American companies file their annual reports with the Securities and Exchange Commission. Among other things, these documents give details of the pay of the companies' top executives. This year these closely watched numbers are being translated into headlines about huge increases in bonuses for the people who run the world's biggest companies. A study by Mercer Human Resource Consulting for the *Wall Street Journal* shows that last year's bonuses for the CEOs at 100 large American companies rose by 46.4%. The median bonus was $1.14m.

These are big bucks, and there are plenty of instances where the logic of the rewards seems at best warped. Michael Eisner, for example, the controversial chief executive of Walt Disney, who was almost booted out of the job by shareholders last year, nevertheless received a bonus of $7.25m. But there are encouraging aspects to the figures. For a start, corporate profits in 2004 rose significantly—those of big quoted firms in the S&P 500 index by some 20%. If bosses' total pay is (as it should be) related to their companies' performance, the variable part of that pay (which includes bonuses) could be expected to have risen sharply during the year.

The other thing about the bonuses is that, to some extent, they are a reflection of a welcome decline in stock-option schemes. Bonuses are being granted in place of these. A study by the Boston Consulting Group of public companies recently found guilty of fraud calculates that the value of the stock options granted to the CEOs of those firms in the years before the frauds became public was 800% greater than those granted to the CEOs of comparable firms not found guilty of any wrongdoing. Nothing correlated so strongly with corporate fraud as the value of stock options—not the standard of the firms' governance, nor analysts' inflated expectations about their earnings, nor ego-boosting stories about their CEOs in the press.

What's more, in the stockmarket's boom years stock options more or less indiscriminately rewarded individuals with sums that frequently amounted to tens of millions of dollars (and sometimes hundreds of millions). In 2001 nine executives cashed in stock options worth more than $100m, including Larry Ellison, the boss of Oracle (who got the biggest bounty, $706m), and Lou Gerstner, the boss of IBM. Mr Eisner's bonus last year fades in comparison. In 2002, the pay of top American CEOs was over 400 times average earnings; last year that figure is reckoned to have fallen close to 160.

The commitment of committees

Bonuses are largely in the control of a company's compensation committee, a small group of non-executive board directors. Nowadays many of these committees are being encouraged to talk regularly with leading shareholders about what are suitable levels of compensation for top executives, and they are increasingly sensitive to the reaction to the amounts they award. In Europe, CEOs are being advised that they will be excluded from much-coveted appointments in the future if they have been too greedy during their executive careers.

There remains plenty of scope for compensation committees to improve. On February 22nd, Merck's board awarded a bonus of $1.4m to Raymond Gilmartin, its CEO. Yet Merck's share price fell by one-third last year and it was forced to withdraw the painkiller Vioxx, a potential blockbuster drug.

But even if all compensation committees were to behave impeccably from now on, there will be legacy problems for some years to come. When earlier this year Carly Fiorina was booted out as CEO of Hewlett-Packard (HP), supposedly a failure, she received a leaving present worth up to $42m. This was because of the terms of a contract signed five years earlier. Compensation committees have to wean themselves off these kinds of pay deals, which lavish enormous amounts on executives even if they fail. Designing schemes that only reward success should not be beyond the wit of directors, or the compensation consultants they employ. In a hurry to find her successor, HP looks in danger of making the same mistake again, while Ms Fiorina herself is being spoken of as a future head of the World Bank. Change for the better? Maybe one should just watch those figures a while longer.

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Letters

Mar 3rd 2005
From Economist.com

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Debating America

SIR – You omit to mention America's role in ending Soviet hegemony as a root cause of much anti-American opprobrium ("The view from abroad", February 19th). Had the former Soviet Union not sought to exercise its malign influence, many nations could have evolved without the interference of outside powers altogether. Unquestionably, America did back a number of unsavoury regimes, but largely out of a desirable reaction to end Soviet meddling and, with the perspective of history, to the long-term benefit of the nations involved.

However, in many of these nations, politicians still peddle the myth of Marxism's moral superiority—even after the fall of Soviet totalitarianism (a perversion of Marxism that created pernicious effects, which persist today). Until this state of denial is ended, and the superiority, but most assuredly not the perfection, of capitalism and democracy is accepted, an open and honest debate regarding the grievances, some legitimate, held by those around the world against America will prove difficult, if not impossible.

Rick Martin
Sunningdale, Berkshire

SIR – Since the rise of America as a global power, the implementation of US foreign policy in world affairs has aimed to protect American interests. The result is a double standard that denies America its perception as a champion of "liberty". In this lies much of the reason for the negative attitude of people affected by American policy in one way or another.

ZUBER OUMER
Addis Ababa, Ethiopia

SIR – You opine that Canada has never suffered anything worse than "cultural imperialism" from America. Yet Americans invaded during the American revolutionary war and the war of 1812. As recently as 1902 America threatened to send troops to settle the Alaskan boundary dispute. Despite these events, the idea that Canada's raison d'être is anti-Americanism lacks a historical perspective; one might as well suggest that the only reason Ireland exists is to be anti-English.

Until the second world war, the most important debate for Canadian public opinion was whether Canadians were British or "Canadian". And, up until the early cold war period, Canadian public opinion was quite in favour of the United States. Perhaps the persistent antiAmericanism that obviously exists today is the result of a long process of disillusionment rather than a perpetual chip on the shoulder?

Caleb Edwards

Toronto

SIR – Ten years ago, while in Montevideo, Uruguay, some graffiti caught my eye. It read: “Yanqui go home, and take me with you.”

Gari Arenas
Rio de Janeiro

Wrong on being right

SIR – By what standard can John Walker Lindh be considered “a leftist”? (Lexington, February 19th). At a young age, he joined an ultra-conservative religious movement and took up arms with the Taliban, a group formed to fight communism that was actively repressing women, homosexuals and all aspects of secular life when he became a member. Indeed, Mr Lindh's political convictions have more in common with America's “rightist” fundamentalists than with those of Susan Sontag, Michael Moore and the other leftists you mention.

Nathan Converse
Washington, DC

Depreciating Germany

SIR – Debunking the popular myth about Germany's lack of competitiveness is highly welcome (“A view from another planet”, February 19th). But why create a new myth about Germany's seemingly virtuous path to ever more competitiveness, especially as the country seems ripe for taking a leap down the deflationary abyss? The idea that deflation might boost investment and jobs in Germany assumes that other European countries will just stand by and watch Germany's beggar-thy-neighbour policies taking their toll on them. Moreover, it would seem unlikely that the rate of wage cutting in Europe could keep up with the dollar's rate of depreciation—which is needed exactly to prevent the euro zone from freeloading on external growth while choking domestic demand in its stability-oriented crusade.

Jörg Bibow
Lugano, Switzerland

The really dismal science

SIR – Abandoning the idea of optimal behaviour would make almost every general equilibrium model used by economists and business scholars unworkable, rendering baseless the long-standing claim of economics to be a “science” (“Bad for business”, February 19th). Foregoing behavioural optimality as a central tenet of economic theory would also make numerous Nobel prizes and thousands of academic articles not worth the paper they are printed on. Given this choice, it is not surprising that economists and business academics choose to ignore reality and confine their intellect to the tenets of simplistic models.

Luis Suarez-Villa
Irvine, California

SIR – A recent study by Stephan Meier and me analysing decisions by students who contribute to charity shows two results. One, business students tend to give less than other students. Two, such behaviour is not due to their education in economics. Rather, persons choosing to study business are less inclined to help others even before they have been subject to any economics teaching.

BRUNO FREY
Zurich, Switzerland

SIR – Unlike medical education, which requires clinical years and an internship, business education has not integrated real-world practice with theory. MBA students are taught to drive by studying the driver's manual, not by being asked to step on the pedal.

Mitchell Langbert
New York

State reliance

SIR – Jonathan Kaplan says that "...there is nothing wrong with relying on the state" for the provision of pensions (Letters, February 26th). May I quote Frédéric Bastiat in response: "The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else."

ATHANASSIOS RIZOS
Thessaloniki, Greece

Fit genes

SIR – You perpetuate a common misconception when you link Ernst Mayr's longevity with his "fitness" (Obituary, February 12th). Evolutionary biologists use fitness to mean a disproportionate genetic contribution to the following generation. To discuss Mr Mayr's fitness, count his children, not his years.

Daniel Bolnick
Austin, Texas

What would Henry say?

SIR – Could someone please explain to me why a church that was founded by a man who divorced or butchered four of his six wives should have any say in whether a fine fellow like Charles should marry his beloved and become head of this self-same church? ("The prince's great matter", February 12th).

Chetan Parkyn
Idyllwild, California

ONLINE ARTICLES

The following correspondence refers to articles published only online

Buttonwood on art

SIR - So what happens to the artwork that the funds currently piling into the market own ("In the eye of the investor", Economist.com, February 22nd)? Do Mr Hoffman and Mr Taubmann have these assets in their homes or offices to enjoy them, are they loaned to museums or are they locked away so that no one can enjoy them? Art is an asset that is intended to provide pleasure

for the owner. This enjoyment can never be captured in the mutual-fund returns. Perhaps I will start a classic car investment fund.

Dan Sheridan

Fairfax, Virginia

Buttonwood writes: Good question. Different funds have different approaches. The Fine Art Fund allows investors to rent the pictures (this presumably saves the fund some insurance and maintenance costs). Fernwood will lend pictures to galleries and museums (thus possibly raising their value on re-sale).

SIR - Buttonwood has long been making the point that most conventional asset classes (equities, bonds, credit spreads, emerging markets) are rich. At least these assets yield an income whereas art does not. So why should art be worth more tomorrow than it is today? It seems to me that rising art prices are merely yet another symptom of too much savings chasing too few investment opportunities. Which brings us back to our expensive asset classes.

Dominique de la Barre

SIR - Asset valuations should bear a close relationship to the net present value of anticipated future cash flows from those assets. In the case of art, more often than not, the only opportunity to generate cash flow is the sale of that art. An awful lot like a chain letter, isn't it?

Giovanni Galleotti

China and Taiwan

SIR - Before settling for economic assimilation as the best way to bring Taiwan back to the Chinese motherland's embrace, one must remember that Taiwan is a vibrant democracy, while China is not ("Worries about weapons, contd", Economist.com, February 23rd). Economic benefit, even if feasible in the foreseeable future, is not the stuff to convince people to trade their freedom for an authoritarian and corrupt regime.

Peaceful integration of Taiwan necessarily involves reform of the Chinese party state. The problem is, naturally, that the party won't selflessly reform itself out of power.

Paulo César Menegusso

SIR - I must object to your article's assertion that Taiwan was ever part of the People's Republic of China (you talk of Taiwan having "run its affairs for half a century" and of China threatening to "retake" the island by force). Historically, Taiwan has never been a province of the People's Republic. The only time that Taiwan has ever been ruled by a Beijing government was during the Ching dynasty, for a scant eight years before 1895. Even then, the government barely had control over parts of the island.

Mark Wu

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Economist.com SPECIAL

Middle East

Something stirs

Mar 3rd 2005 | BEIRUT, CAIRO, DAMASCUS, RAMALLAH AND WASHINGTON, DC
From The Economist print edition

AP

Two years after the invasion of Iraq, the Arab world is beginning to show tantalising signs of change

Get article background

SINCE the American invasion of Iraq in March 2003, many of those who vehemently opposed it have mocked America's neo-conservatives for having believed that the Iraqis would greet their foreign liberators with flowers and gratitude. Now it is the turn of the neo-cons to mock. A lot of people in the anti-war camp predicted that the war would cause upheavals across the Middle East, fanning hatred of the West and tipping friendly regimes into the hands of Islamist extremists.

It hasn't worked out that way. On the eve of the war's second anniversary, the Middle East does indeed seem to be in the grip of some sort of change. But, right now, much of the change seems to be pushing in a welcome direction, towards a new peace chance in Palestine and the spread of democratic ideas around the Arab world.

Arabs everywhere were affected by the spectacle in January of Iraqis defying terrorists to cast their vote and elect a new government, and of Palestinians managing to hold a free election even while under Israeli occupation. The past week has brought even more transfixing scenes, as Lebanese thronged the streets of Beirut with their flags in an unprecedented show of “people's power”, forcing the country's pro-Syrian government to resign. At the same time, Hosni Mubarak, Egypt's president for the past 24 years, has astonished his countrymen by calling for constitutional changes to allow rival candidates to vie for his position for the first time.

To the instigators of the Iraq war, all this is manna from heaven. Having failed to find weapons of

mass destruction in Iraq George Bush and Tony Blair have been forced to emphasise instead the gift of freedom their toppling of Saddam Hussein delivered to its people. This “gift” was hardly free: chaos and murder continue to stalk Iraq. This week alone, at least 120 people were killed in a single suicide bombing in Hilla. And yet the Iraqis do still seem impressed by the novelty of being able to vote a government out of power.

In Bratislava a fortnight ago, Mr Bush drew a link between Iraq's vote, Czechoslovakia's “velvet revolution” of 1989, Georgia's “rose revolution” at the end of 2003, and Ukraine's recent “orange revolution”. He would say that. But a growing number of Arab voices are chiming in, too.

In a widely noticed interview, Walid Jumblatt, the leader of Lebanon's Druze, told the *Washington Post* that Iraq's election was the Arab equivalent of the fall of the Berlin wall. Hisham Kassem, a former publisher of the *Cairo Times*, called the elections the “start of a ripple effect”. Khaled al-Meena, the editor of Saudi Arabia's *Arab News*, says that if elections can be held under foreign occupation in Iraq and Palestine, it should be much easier to hold them in Arab states said to be “free”.

How far-reaching is this new spirit? The Arab world is large and diverse, so there is always a risk of connecting the dots in a way that produces a distorted picture. One oddity is that Iraq, Palestine and Lebanon—all three of the prime exhibits being used to make the case for democracy—happen to be under foreign occupation, by America, Israel and Syria respectively. Each is in many ways a special case.

A cedar revolution?

The foreign occupation of Lebanon began in 1976, when Syria's dictator, Hafez Assad, sent his army to intervene in Lebanon's brutal three-cornered civil war between Maronite Christians, Muslims and Palestinians. The mass protests that forced Lebanon's pro-Syrian government in Lebanon to resign this week would probably not have happened but for a powerful shock: last month's murder of Rafik Hariri, the country's former prime minister and most popular politician. This was the catalyst for a chain reaction. For the Lebanese, what some are calling a “cedar revolution” and others a “peaceful *intifada*” carries the promise of an end not just to Syrian occupation but also to a corrupt spoils system that has long sapped the country's talent and morale.

Broad-based popular movements such as this are unlikely to emerge soon in other countries. Lebanon's experience is in many ways unique. Famously fractious, the Lebanese are well educated and politically sophisticated. Their central government is weak, meaning it lacks the instruments of control enjoyed by other Arab states. It cannot co-opt enemies with oil money, because it has none. It cannot suppress protests effectively, because it lacks even a trained force of riot police. And it cannot silence dissent, because Lebanon's vibrant press has remained in private hands. The enthusiastic, non-stop coverage of the Beirut *intifada* on opposition TV channels emboldened tens of thousands of ordinary citizens to ignore government bans, and take to the streets.

Just now, something else distinguishes the Lebanese: they have a focus for their anger. Mr Hariri had come to embody the country's post-war reconstruction. His assassination united Lebanon's multiple factions in outrage. A beleaguered minority movement, led by Christian and Druze politicians who once fought each other, was reinforced by members of Mr Hariri's own Sunni Muslims, as well as thousands of others whose indignation transcended the old sectarian loyalties.

Lebanon's anger has a cause as well as a martyred hero: freedom from domination by Syria, whose regime many Lebanese instinctively blame for the crime. Over the years, Syria's occupation helped to smother the flames of civil war and bolster Lebanon's resistance to Israel's occupation of

the south. But the war is long over, the Israelis have gone and the Syrians have overstayed their welcome. They are blamed now for imposing some of the ills that afflict other Arab countries, such as grotesque corruption, intimidation of political opponents, and the subversion of the courts. When the Lebanese demand the return of national sovereignty, it is as much a call to restore local freedoms as for Syria's troops to leave.

Democrats in Palestine

In Palestine, too, the advance of democracy may have been helped by the weakness of the government. The Palestinian Authority (PA), created by the 1993 Oslo accords to run the occupied territories until a final deal on statehood was reached, is missing many of a sovereign state's usual attributes. Israel controls natural resources, borders, coast and airspace, the currency, the collection of customs duties, and, in most areas, security and internal freedom of movement. Yet Palestine's political system is vibrant and pluralistic.

Ironic, but no accident: Israel's occupation is directly responsible. The two *intifada*s bred a powerful grassroots movement, subverting the Middle East's usual authoritarian tendency. Yasser Arafat's periodic attempts to placate Israel by cracking down with his brutal security services alienated the population, as did graft among his officials. In polls done for January's presidential election by the Palestinian Centre for Policy and Survey Research, 26% of voters rated corruption and lack of reform as the most serious problem facing Palestinians, only slightly behind the occupation (31%) and poverty (33%).

Arafat's death has triggered a quiet cascade of mini-revolutions. January's presidential election delivered a predictably solid victory to Mahmoud Abbas (Abu Mazen), his designated successor in the ruling Fatah party, but also a strong showing to Mustafa Barghouti, an independent without any of the benefits of a party structure, previous political jobs or slyly-used state funds.

In the early rounds of the municipal elections, Hamas, the main Islamist party, did unexpectedly well. This July it can expect to win a hefty minority in the Palestinian Legislative Council (PLC), whose current members smell pretty ripe to ordinary Palestinians after a decade in their seats.

Hamas is popular for its armed efforts in the second *intifada*, which most Palestinians believe forced Israel's planned withdrawal from Gaza, and for its broad network of local social services, trumping those of the PA. It also did well because many would-be Fatah candidates grew so sick of the old leadership's habit of overriding internal primaries and imposing its own people that they ran independently, thus splitting the vote for the party. But these habits are changing: a frightened Fatah is beginning to heed its younger members' calls for reform.

Reuters

Mahmoud Abbas and friend, perhaps

And there was another upset last month when the Palestinian prime minister, Ahmed Qurei (Abu Alaa), tried to appoint a cabinet packed with Arafat loyalists. Shrewdly, rather than press Mr Qurei to make changes, Mr Abbas sat back and let him get into a showdown with PLC members who wanted their turn. The end result: a “technocrat” government, made up of politically inexperienced but professional people, and few Arafat cronies or PLC hacks in sight. How well it will govern remains to be seen, but Palestinians love it: shortly after the government was sworn in, a Ramallah street vendor was heard hawking “technocrat bread”.

Reform of the PA has been on the agenda since well before Mr Abbas. Salam Fayyad, the Authority's determined finance minister, has spent nearly three years cleaning up the books, and says its revenue collection has gone up from $45m to $75m a month, even as the economy has withered under the *intifada*. Mr Abbas, mindful of Fatah's plight and the fact that his own poll rating was close to zero before he became the party's candidate, is carrying on with those plans.

The PA outlined them at a meeting this week in London with donors and Middle Eastern governments. Pension reform will help slim down the civil service, which until recently was a sponge for unemployment, by encouraging desk-jockeys to retire. There will be clear procedures for appointing judges and a shake-up in the court system. The dozen-or-so security services (not even PA officials agree on the exact number), which functioned as private fiefs, will be slimmed down, smartened up and brought under central control. There will be tweaks to fiscal management and business law, and a raft of other changes. In return donors upped their pledges of support to $1.2 billion for 2005, and Palestine broke a new record for aid money per head of population.

Please may we have independence too?

Palestinians plainly welcome reform for its own sake. Above all they want the occupation to end. Yet Israel insists—and for now the Americans seem to agree—that the Palestinians must put their domestic house in order before they will be allowed to negotiate the final status of their putative independent state. As in Lebanon, therefore, the grassroots appetite for bottom-up democracy and the impulse for independence combine into a potent force.

That is no longer true of many Arab countries, where the kings and “national liberation” parties that took power after the colonial period have clung ruthlessly to office ever since. Yet in the past year or so, even governments of that sort have been making some concessions to democracy. In some cases this has been done for domestic reasons, in others as a response to pressure from the Americans. Morocco's politics have matured lately into a lively multi-party system, albeit under the

supervision of an almost absolute monarch. Another semi-constitutional monarchy, Jordan, plans to devolve central powers to elected regional bodies. Yemen, though still tribally fractious and backward, boasts a rowdy parliament and press.

Even the absolute monarchs of the Gulf have opened up to varying degrees of citizen participation. Qatar's emir, the first Arab ruler to abolish his own ministry of information, actually congratulated the Lebanese for toppling their government. Kuwait, which has long had a noisy parliament, is on the verge of enfranchising women, now that Islamists back the idea. In Bahrain, Oman and Qatar, women already vote. And Saudi Arabia is in the midst of electioneering as polling for town councils continues across the kingdom.

Change, and the illusion of change

Needless to say, much of this top-down reform has been hesitant and shallow. In none of these cases has the real balance of power been threatened with change. Essential attributes of an open society, such as full scrutiny of state spending, an unfettered press, truly independent courts and accountable police and security forces remain unachieved. The changes often look less like Mr Bush's forward strategy of freedom than like a rearguard strategy of regime survival.

AP

A more orderly class of protest in Cairo

Mr Mubarak's initiative, for example, concedes none of his pharaonic powers, including the right to be re-elected in perpetuity. According to the draft forwarded to Egypt's rubber-stamp parliament, presidential candidates would have to be proposed by legal parties. The hitch is that Mr Mubarak's own party controls the legalising process. It may not sanction its most formidable opponent, the Muslim Brotherhood. After 50 years of virtual one-party rule, the political stage has been almost swept clean of potential contenders, aside from the 76-year-old Mr Mubarak and, perhaps, his 42-year-old son Gamal. Besides, Egyptians are so inured to electoral fraud and manipulation that it may prove hard to persuade them of the utility of voting.

The arrest in January of a prominent young opposition parliamentarian, Ayman Nour, underscored the sanitised nature of Egypt's politics. Mr Nour's secular, liberal al-Ghad (Tomorrow) party had only recently been legalised. Unlike tamer opposition politicians who had agreed to put off calls for change until after Mr Mubarak's re-election, Mr Nour had been demanding immediate constitutional reform. For his pains he was accused of forgery, had his parliamentary immunity lifted, and was clapped in jail. He remains locked up, but responded to Mr Mubarak's initiative by

calling off a hunger strike.

The experience of Algeria and Tunisia, which already permit competition for the presidency, is not encouraging. Tunisia's ruler of the past 17 years, Zeineddine Ben Ali, has twice crushed challengers, but these lightweight rivals were carefully vetted, and forced to play on a steeply tilted field. Algeria's Abdelaziz Bouteflika handily won a fairer race last year, but with the full support of state media and other government institutions.

Arabs complain that their rulers' gestures towards reform come more in response to outside pressures than to their own aspirations. Mr Mubarak's proposal would not have been made but for the supposedly friendly nagging of Mr Bush and Condoleezza Rice, America's new secretary of state.Yet pressure for reform is also building from within. Hollow or not, each grudging reform has whetted the public's appetite for further change.

In the past, popular protests often took the form of riots over price rises or localised protests at police brutality. Now “people power” is increasingly being expressed in organised and peaceful movements by civil-society groups. Bahrain's ruler, for example, brought himself immense popularity three years ago by ending martial rule, inviting exiled dissidents home, and running free elections for half the seats in the national legislature. Many Bahrainis, particularly among the disenfranchised Shia who make up two-thirds of the island kingdom's native population, are now demanding more.

Jordan's King Abdullah, likewise, faces a wave of unrest from trade unions angered by new rules that ban syndicates from political activity. In Egypt, Mr Mubarak's election initiative was greeted not with gratitude, but with demands for wider freedoms and better guarantees that polls will really be clean. A small but vociferous reform movement has gained momentum in Cairo, drawing strength from the coverage of protests by satellite TV channels that are beyond state control, and a proliferation of groups promoting specific issues, such as ending torture.

Goodbye Baathism

Even in Syria the feeling that change is inevitable has become palpable. Hafez Assad's son Bashir has proved a weak leader, isolated both by the war in Iraq and his behaviour in Lebanon. Many other Arabs still share the Syrian regime's sense of being under siege, its deep mistrust of the West, and its loathing for Israel. Yet they are also aware that the armed *intifada* in Palestine and the Iraqi insurgency have lost their sheen. They know that state socialism is a dud, and—after Saddam Hussein's fall—that dictatorship is ultimately disastrous. Growing numbers are willing to say that Islam is threatened more by its own demons than by the West's armies.

An Arab democratic opening will be long and tortuous. The regimes that block it are strong, cunning and ruthless. The rhetoric of “resistance”—Islamist, Arab nationalist, anti-American, anti-globalisation, or whatever—retains a powerful grip. Many Arabs still support groups such as al-Qaeda. A huge amount still depends on the outcome in Iraq: a descent into chaos or the failure of the political process there could crush democratic stirrings throughout the region. For all these reasons, it is probably too early for the Americans to crow about an Arab year of revolutions. All the same, the distance between George Bush's talk of freedom and Arab aspirations, which only recently seemed to yawn so wide, may at last be starting to close.

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Medicaid reform

The next big thing

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Corbis

As the chances of pension reform get dimmer, Medicaid looks likely to be this year's consummate budget battle

UP TO now, Social Security reform has dominated debate in Washington. But it is becoming clear that the real budget battle this year will be about Medicaid, the health-care programme for the poor that is financed jointly by the federal government and the states.

Mr Bush's plan for pension reform is floundering. This week Bill Frist, the top Republican in the Senate, admitted it might be put off until next year (in other words, indefinitely). Meanwhile, the president's proposal to trim $60 billion—or 2%—from federal spending on Medicaid over the next ten years has sparked a furore. State governors, in Washington for their annual winter meetings this week, talked about little else—and furiously lobbied congressmen to oppose the cuts. Whereas Social Security seemed a far-off crisis, everyone agrees that Medicaid's troubles are pressing. The question is how to fix them.

Set up in 1965 to provide health care for the poor, Medicaid, with a total cost of over $320 billion, is now, alongside Medicare, America's biggest government health-care programme. Uncle Sam pays between 50% and 77% of the tab, depending on how poor a state is: on average, 57 cents out of every dollar Medicaid spends. Over 50m Americans rely on the programme for their health care. Most of those who enroll are poor families with children, but most of Medicaid's money is spent on old and disabled people, particularly on nursing-home care. (Medicare, the federally-funded programme for the old, covers only doctor visits, hospital visits and, from next year, prescription drugs.) Medicaid pays for two-thirds of all nursing-home residents in America.

Medicaid spending has soared in recent times (up 63% in the past five years) thanks to rising

health inflation, growing numbers of old people and the long-term decline in employer-provided health insurance. Although Medicaid's costs per participant have risen more slowly than private health-insurance premiums (6.9% a year between 2000 and 2003, compared with 12.6% in employer-sponsored plans), the number of new participants has accelerated spending. With no change in the law, the Congressional Budget Office expects Medicaid spending to rise by almost 8% a year in the coming decade.

Set against that trajectory, Mr Bush's proposals are extremely modest. He wants to trim a mere 2% from Washington's contributions to Medicaid by tackling those old faithfuls, “waste, fraud and abuse”. Other programmes that provide health care for the poor would see a $15 billion rise, so the net loss to the states would be even smaller. The White House suggests several areas where money could be saved, including cutting the prices Medicaid pays for prescription drugs and tightening the rules on when Medicaid pays for nursing-home care. At present, the administration believes, too many old people shift assets to their children and then claim poverty so that Medicaid picks up the tab.

The White House also wants to crack down on “creative accounting” by the states. Given the size of the federal match for state Medicaid spending, states have a huge incentive to overcharge Medicaid to get more federal money. Mr Bush also wants to give the states more flexibility to design their Medicaid systems, but without increasing the cost to Uncle Sam.

Mike Leavitt, the secretary of health and human services and a former governor of Utah, wants quick agreement with state governors on these proposals so that, together, they can influence the budget debate in Congress. But the governors are deeply sceptical. They acknowledge that Medicaid needs fixing (despite the federal matches, rising Medicaid costs are a huge fiscal problem for the states). They like the idea of being able to try new approaches to the programme. But they resent any efforts to limit the federal government's financial contribution. Flexibility with financial caps, they fret, is simply code for palming off the financial burdens of Medicaid on to the states. Much high-minded talk at the governors' meetings was on the theme that, rather than allowing short-term budget concerns to drive Medicaid policy, the president should let serious policy reforms drive the budget.

To a degree, the governors have a point. Mr Bush's budget ideas are not real reforms. Trimming costs by $60 billion over a decade barely makes a dent in Medicaid's more fundamental problems. Moreover, the sensible cost-cutting suggestions that Mr Bush made may not be in the final budget, and even if they are they may not actually save much money. Washington has tried to stop states' creative accounting for years; the practice still goes on. Efforts to cut drug prices, let alone tighten up the rules for asset-shedding by middle-class pensioners, will face howls of protest from powerful political groups. Medicaid's supporters worry that congressional budget writers will craft a budget that includes cuts, but that those cuts will be badly designed, will hurt the weakest most and will do nothing to deal with Medicaid's long-term mess.

That is possible. But without the spectre of budget cuts, rhetoric about more fundamental reform is unlikely to go anywhere. It has been clear for years that the ageing population will put huge strain on both Medicare and Medicaid, yet nothing has been done. And, thus far, the state governors' ideas of reform simply involve transferring more of the costs to Uncle Sam. They are keen, for instance, to get Medicare to pick up the tab for the poor old people who are jointly eligible for both Medicare and Medicaid.

Medicaid is at the centre of two of America's biggest social conundrums: how to pay for the care of a greying population and how to ensure that poorer Americans—in a world of rising health-care costs and shrinking employer provision—get access to medical care without creating an unbearable fiscal burden. To achieve serious reform, both the states and the federal government need to get past the idea of piling costs on each other and start tackling these bigger issues. Mr

Bush's proposed budget cuts are pretty feeble, but they might set that ball rolling.

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Mental health

Stressed out and traumatised

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Americans feel increasingly troubled, and war doesn't help

AFP

The most vulnerable

“EVERY generation”, cautions Howard Goldman of the University of Maryland School of Medicine, “thinks it's more stressed out and souped up than the rest.” True indeed. But more and more Americans are seeking help for mental problems, and many are doing so younger. One study, conducted among students at a large mid-western university between 1988 and 2001, showed a dramatic increase in mental-health problems reported by college students: the number seeking help for depression doubled, while the number with suicidal tendencies tripled. Another study found that, in 2001, 5.5m more Americans were taking prescription drugs for mental-health problems, or problems of substance abuse, than was the case only five years earlier.

About one in five Americans now suffers from a diagnosable mental disorder. The National Institute of Mental Health estimates that more than 13% of Americans—over 19m people between the ages of 18 and 54—suffer from anxiety disorders, 9.5% from depressive disorders and millions of others from conditions ranging from post-traumatic stress disorder (PTSD) to schizophrenia and bipolar disorder.

Women are more likely than men to experience the most common problems, including anxiety and depression. People with mental illness are also more likely to be divorced and jobless than the general population. Yet mental illness cuts across gender, race and class, from society matrons taking modish therapy to homeless people sleeping by the railway tracks.

Increasingly, too, battle-scarred soldiers are joining the ranks of the mentally ill. Of about 245,000 soldiers discharged from service in Iraq and Afghanistan, more than 12,000 have sought counselling for symptoms of PTSD. The army is trying to detect symptoms early, before they become difficult to treat, but already the war in Iraq is producing the most seriously traumatised

body of veterans since the war in Vietnam.

The impact on society, in both human and economic terms, is substantial. Four out of ten leading causes of disability in America (and other developed economies) are mental disorders. They lead to absenteeism, lost wages and joblessness. The World Health Organisation has predicted that, by 2020, the share of the "global disease burden" (ie, the years of healthy life lost to premature death or disability) contributed by psychiatric and neurological conditions will rise from 10.5% in 2001 to nearly 15%—partly because the population is getting older, and partly because infectious diseases are looming less large in the picture.

Some conditions, such as anxiety disorders, appear to be more common in America than in other developed countries. Ronald Kessler, of Harvard Medical School, suggests that some of this may stem from childhood trauma and early involvement in drugs with which young Americans dabble more. But he and others are hesitant to suggest that Americans have more mental-health problems overall than the rest of the world. They may just be more willing to admit them. In China, for instance, "very few people say they are depressed," notes Dr Kessler. "They just kill themselves."

Where doctors fail

Laurie Garduque of the MacArthur Foundation, a big funder of research in mental health, points to three key issues that plague the mentally ill in America: a gap between the latest research findings and actual treatment; a gap in access to treatment; and the ongoing stigma of mental illness, which she says is "alive and well".

Concerns about two-tier treatment are voiced by many in the field. Treatment depends largely on ability to pay; the wealthy tend to see private psychotherapists or their family doctors, while the poor are shunted into community health programmes or simply go untreated. For those without employer health plans, it is often impossible to get independent insurance coverage with a pre-existing condition like depression. The quality of care varies widely, too: no more than one-third of mentally ill people in treatment are believed to get minimally appropriate care.

Because insurance reimbursements for treatment of mental illness lag behind those for physical ills, doctors have few incentives to counsel patients on the issue. Yet primary-care doctors play a vital role: at least 10% of visits to them are by patients with underlying psychological problems.

The trend away from psychotherapy and towards treatment with medicines worries many in the field, not least because of a debate over the potential side-effects of anti-depressants. (These are still available to teenagers in America, though banned in Britain because they seem to increase the risk of suicide.) The shift away from therapy has occurred not only because drugs have become more effective, but also because they are easier to administer alone. Perhaps because of this trend, there are now too many psychotherapists in large cities on the coasts. But while the shrinks of LA and Manhattan may be finding more time for golf, psychologists and psychiatrists are desperately needed in smaller communities across the heartland where—contrary to the tranquil rural image—too many Americans are traumatised, worried or unhappy.

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“Enemy combatants”

Free him, or charge him

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Mr Bush has no power to hold American citizens without trial

Get article background

AP

Padilla, incommunicado

THE judge did not mince his words. Henry Floyd, presiding in a district court in South Carolina, ruled this week that President George Bush had greatly exceeded his authority in detaining an American citizen as an enemy combatant for nearly three years without charge or access to a lawyer. The president, he said, had “no power, neither express nor implied, neither constitutional nor statutory” to do so.

Judge Floyd, who was appointed to the federal bench by Mr Bush just two years ago, ordered that the American, José Padilla, be charged with a crime or released within 45 days. “To do otherwise”, he said, “would not only offend the rule of law and violate this country's constitutional tradition, but would also be a betrayal of this nation's commitment to the separation of powers.”

Mr Padilla, a former Chicago gang member, was arrested at that city's O'Hare airport on his return from Pakistan in May 2002 on suspicion of plotting with al-Qaeda to produce a radioactive “dirty bomb”. He has been held incommunicado ever since in a military brig in Charleston, South Carolina.

Judge Floyd rejected the administration's claim that the president had blanket authority under the constitution to detain Americans suspected of taking or planning actions against the country. The government had presented no law supporting that contention. Moreover, said the judge, “if such a position were ever adopted by the courts, it would totally eviscerate the limits placed on presidential authority to protect the citizenry's individual liberties.”

Judge Floyd's opinion echoed the Supreme Court ruling last summer in the case of Yaser Esam Hamdi, another American who was designated an “enemy combatant” after being captured in Afghanistan in late 2001. He was held without charge or access to family or lawyers in the same military brig as Mr Padilla.

In *Hamdi*, the justices repudiated the Bush administration's view that enemy combatants could be held indefinitely without the right to challenge their detention in the federal courts. “We have long since made clear,” wrote Justice Sandra Day O'Connor for the majority, “that a state of war is not a blank cheque for the president when it comes to the rights of the nation's citizens.” Three months later, Mr Hamdi was released and sent back to Saudi Arabia, where he had lived for some years. The government said that he no longer posed a threat to American security and was of no further intelligence value.

In a further blow to the government, two human-rights groups, the American Civil Liberties Union and Human Rights First, have filed a lawsuit in a federal court accusing Donald Rumsfeld, the defence secretary, of bearing “direct responsibility” for the torture and abuse of American-held detainees in Afghanistan and Iraq. In an action brought on behalf of eight former detainees, they are seeking a court order declaring that Mr Rumsfeld's personal authorisation of aggressive interrogation techniques, such as sleep deprivation, threatening with dogs and keeping prisoners for hours in agonising “stress positions”, violated both the American constitution and international law. The eight men, all of whom claim to have been tortured by their American guards, were eventually released without charge.

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The death penalty

Too young to die

Mar 3rd 2005
From The Economist print edition

The views of the rest of the world matter, too

Get article background

THE United States is the only country in the world that officially sanctions the execution of juvenile offenders under the age of 18. Indeed, it is one of very few developed nations to retain the death penalty at all. In 1988, the Supreme Court ruled that capital punishment for offenders under the age of 16 was unconstitutional. But the next year it determined that this did not apply to older juveniles. Now, just a decade and a half later, in a dramatic reversal, it has abolished the death penalty for all offenders whose crimes were committed when they were under 18, reprieving 72 juvenile offenders on death row.

No one doubts that the case on which the high court passed judgment this week involved a particularly cruel and callous murder. In 1993 Christopher Simmons, a high-school student from Missouri, broke with the help of a friend into a house where Shirley Crooks was asleep. He tied her up, wrapped her face in duct tape, then threw her, still alive, off a bridge into the river below.

Mr Simmons, then aged 17, bragged about the murder both before and afterwards. He was arrested the next day, confessed and was convicted nine months later. In mitigation, his defence counsel reminded the jurors that, in Missouri, juveniles of Mr Simmons's age could not drink, serve on juries, or even see certain types of film because “the legislatures have wisely decided that individuals of a certain age aren't responsible enough”. The jury nevertheless recommended the death penalty. After a series of unsuccessful appeals, it looked as if Mr Simmons had reached the end of the line.

But a judgment by the Supreme Court in 2002, prohibiting the execution of mentally retarded offenders as “cruel and unusual punishment”—banned under the eighth amendment—provided fresh opportunity for an appeal. In an echo of that earlier judgment, the Supreme Court refers to “evolving standards of decency” as justification for its ruling this week.

The trend towards the abolition of the juvenile death penalty at state level, said the court, provided sufficient evidence that society today regards all juveniles under the age of 18 as “categorically less culpable than the average criminal”. Although 20 of America's 50 states retain capital punishment for juvenile offenders, since 1976 only 22 such offenders have been executed. And although Americans overwhelmingly want to keep the death penalty for adults, polls suggest that some two-thirds are against it for juveniles.

But the court has sparked immediate controversy by admitting that its reinterpretation of the constitution was influenced at least in part by foreign laws and attitudes. “The overwhelming weight of international opinion against the juvenile death penalty is not controlling here,” Justice Anthony Kennedy wrote for the majority, “but provides respected and significant confirmation [of the ruling].”

This prompted an angry minority dissent, read by Justice Antonin Scalia, the leading conservative on the bench and a possible successor to Chief Justice William Rehnquist, who is ill. “Though the views of our own citizens are essentially irrelevant to the court's decision today, the views of other countries and the so-called international community take centre stage,” he raged. “The basic premise of the court's argument—that American law should conform to the laws of the rest of the world—ought to be rejected out of hand.”

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Church and state

Go down, Moses?

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The Supreme Court gets to grips with the Ten Commandments

AP

The Ten Commandments
I AM the LORD thy God
Thou shalt have no other gods
Thou shalt not make
images
Thou shalt not take the Name of the Lord
thy God in vain

A suspiciously prominent position

HIS law licence was suspended for failing to do work for which he had been paid. With no office to work from, he has to do his research in libraries, and he lives in a tent in a woodsy bit of Austin. Yet none of this has stopped Thomas Van Orden, the “homeless lawyer”, from arguing his case against the state of Texas all the way to the highest court in the land. Mr Van Orden, on his daily strolls in the grounds of the Texas capitol, became perturbed by a six-foot-high red-granite monument of the Ten Commandments that sits between the statehouse and the state Supreme Court. It was, it seemed to him, a clear violation of the constitution.

So he sued. He argued his case before the federal district court and appeals court, losing both times. But on March 2nd the Supreme Court heard his appeal, along with another involving framed copies of the Ten Commandments removed from two Kentucky courthouses. This time, the homeless lawyer let Erwin Chemerinsky, an expert on constitutional law from Duke University, present his case.

Mr Van Orden raises a fair point. The monument is plainly religious from the word go: “I AM the LORD thy God. Thou shalt have no other gods before me.” Meanwhile, the first amendment's “establishment clause” is equally uncompromising: “Congress shall make no law respecting an establishment of religion.” Besides, by erecting the monument, the state appears to be favouring some religions, the Jewish and Christian, over others.

Proponents argue back that Moses's tablets, while explicitly religious, are also historical. They ask whether, as one of the foundations of western law, they really need to be scoured from the public sphere. (Indeed, there would be lots of scouring to do: thousands of Ten Commandments

monuments are scattered in public parks and civic buildings throughout the country, and a frieze of Moses with the tablets hangs in the Supreme Court itself, over the chief justice's head.) Defenders of the displays also argue that the establishment clause was never intended to banish all state reference to religion, but simply to prevent the government from creating a national church or from favouring a particular religion (and here they insist, rather implausibly, that the Ten Commandments are embraced so broadly that they hardly belong to any one religion).

During this week's hearings, the court seemed to agree with Mr Van Orden that displays of the Commandments send a primarily religious message. But they were sceptical about tearing them down. Justice Anthony Kennedy talked of “an obsessive concern with references to religion”. Later he added: “If an atheist walks by, he can avert his eyes.”

The court last ruled on the Commandments in 1980, when it struck down a law requiring that they should be hung in Kentucky classrooms. Yet a mute homage to the Commandments in, or outside, a civic building is hardly the same as a required display in a school. And the court has allowed religious displays in public places in the past. What matters is intent. The court once ruled that a nativity scene on city property appeared to have a “secular purpose” because it included a reindeer and Santa Claus.

But divining purpose is not easy. The district court and the 5th Circuit Court of Appeals have ruled that the Texas monument is merely one of 17 scattered on the capitol grounds that celebrate Texas's history and culture. Indeed, it said that no reasonable person wandering in the grounds would suppose that the state was endorsing religion. But the state's intent, when it accepted the monument in 1961 from a group called the Fraternal Order of the Eagles and placed it rather prominently next to the statehouse, is murky. The effect, Mr Van Orden insists, is that the state appears to be promoting religion symbolically.

Meanwhile, the district court and the 6th Circuit Court of Appeals have ordered two Kentucky counties to take down framed copies of the Ten Commandments hanging in their courthouses, even after they added a number of other documents—copies of the Declaration of Independence, “The Star Spangled Banner” and the Bill of Rights—and put up a sign asserting that the display honoured the foundations of American law and government. The Supreme Court itself, in the 1980 case, ignored Kentucky's stated purpose—a “secular application of the Ten Commandments”—for posting the displays in schools. The commandments, it said, were “plainly religious”.

Given these inconsistencies, it is likely that the Supreme Court, when it hands down its ruling sometime in June or July, will propose a guideline for what constitutes a proper religious display on public property. It is also hoped—and indeed feared—that it will go further, and illuminate just how much religion in public life the Founding Fathers intended.

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New York's schools

Let freedom reign

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Smaller proves better in the Big Apple

Get article background

THE Evander Childs High School in the Bronx has long been one of New York City's worst. It is violent, unruly and woefully ineffective: less than a third of its 2,500 students graduate within four years and, even after seven, only 54% manage to earn a diploma.

So in early February New York's mayor, Michael Bloomberg, announced that Evander, along with a handful of similarly troubled schools, would be gradually shut down. Taking their place will be a throng of 200 new “small schools” and charter schools, with the number of pupils capped at 500-600. On February 15th, Mr Bloomberg's mission was given a boost by the announcement of another $32m in grants from the Gates Foundation, founded by Microsoft's Bill Gates, to go towards 35 new small schools.

The rambling brick building that is home to Evander is already the site of both the old and new order. Evander still limps along, but shares its hallways and facilities with six small-school upstarts. Among these, one stands out: the Bronx Laboratory School, which occupies just four classrooms on Evander's crowded second floor. It is one of 29 small schools that are part of the “autonomy zone”, a pilot programme launched quietly by the city's Department of Education (DoE) last autumn.

The idea behind the zone is simple. In order to hold schools accountable for pupils' academic performance, principals must be free to make decisions that matter. In practice, this means that high schools in the autonomy zone—a hodgepodge of start-up schools, charter schools and highly regarded, longstanding public schools—can opt out of many of the rules that weigh on the rest of the system. For the moment, these are mostly curricular and teacher-training rules, but in future teachers may be given freer rein over budgetary and purchasing decisions. (Union contracts and testing requirements, which are state-mandated, are not on the table.)

In exchange, autonomy-zone schools agree to be held to strict five-year performance targets. These include attendance rates, over time, of 90% (which small schools managed to achieve last year) and graduation rates of 80%—a high bar in a city where the average four-year graduation rate is just over half.

The autonomy zone stands in sharp contrast to the “centralising” trend of school reform under Joel Klein, the schools chancellor. One of Mr Klein's first acts was to rationalise New York's diffuse school system: stripping community school boards of much of their decision-making power, collapsing 40 school districts into ten, and adding another layer of “local instructional superintendents” (LISs) below this to oversee schools directly.

Mr Klein also pushed through a mandated curriculum for English and maths, which the DoE hopes to expand to other subjects. This prescribes what schools must teach, how they should teach it,

even how long instruction should be (one-and-a-half hours a day for each subject, broken down into smaller modules). To many teachers, it all seems a bit much.

Autonomy-zone schools are happily free from both these reforms. They lie outside the normal school hierarchy, reporting not to LISs but directly to Eric Nadelstern, the part-time head of the pilot programme at the DoE and a former charter-school principal. Mr Nadelstern leaves them free to teach what they like in the way they like.

Teachers and principals in the zone say this flexibility is crucial if they are to succeed. But the DoE says that the mandated curriculum and other reforms lend much-needed discipline to a school system that has floundered for decades. Autonomy may be the future but, in New York City's gargantuan public-school system—over 1.1m children and 1,350 schools, bigger than many state systems—the DoE believes it is better to take things slowly. Elsewhere, too, the smattering of school districts that are experimenting with similar autonomy schemes—Boston, Chicago, Oakland—are taking their time. Pupils and parents may well wish they were going faster.

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Hunting in Texas

Virtual adrenalin

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Setting a mouse to catch a hog

WHEN Howard Giles saw the wild hog step into the crosshairs of the high-powered rifle, he felt that familiar rush of adrenalin he so often craved as a young hunter in the Texas Hill Country. But this time only the hog was in the Hill Country. Mr Giles was sitting behind a computer screen in San Antonio, 45 miles away, preparing to bag his prey with the click of a mouse.

Live-Shot.com allows anybody with an internet connection to log on and shoot real guns in real time. And even in Texas, where gun control means holding your rifle steady, the concept of hunting over the internet has generated controversy. Wildlife authorities want to stop any killing of native species—including feral hogs, brought to Texas by the Spaniards centuries ago—by remote control. Now Todd Smith, a Republican state representative, has introduced a bill that would ban it altogether.

John Lockwood, the owner of Live-Shot.com, objects to this. He says his fledgling business differs little from ranches that offer traditional guided hunts. For one thing, there is always somebody on-site monitoring equipment and standing by with a backup rifle if things get messy. He also says the animals are just as free-ranging as on any Texas hunting ranch. Anybody who wants to pay $300 for a virtual hunt (meat processing, shipping or taxidermy costs not included) also has to get a Texas hunting licence—obtainable over, yes, the internet.

People think, says Mr Lockwood, that he has a gun trained on animals in a pen night and day and "you can log on anytime you want and shoot it." Not so. Hunters will pay for two hours of time and get two rounds fired from a 30.06 rifle mounted on a pan-tilt motor. While hunting seems to thrill the most, Mr Lockwood says the real money at the moment is in target shooting, for which nearly 400 people—some as far away as Germany and Australia—are paying $14.95 a month and $5.95 a time to fire ten rounds at balloons or toy sheep.

Mr Giles says he is honoured that Mr Lockwood, a friend and co-worker, chose him for the first internet hunt—even if Mr Lockwood had to grab his rifle and finish off that wild hog after Mr Giles's first shot didn't quite do the job. "It's a real hunting feeling," Mr Giles said. "I held my breath right before I clicked the mouse. I felt like I was there."

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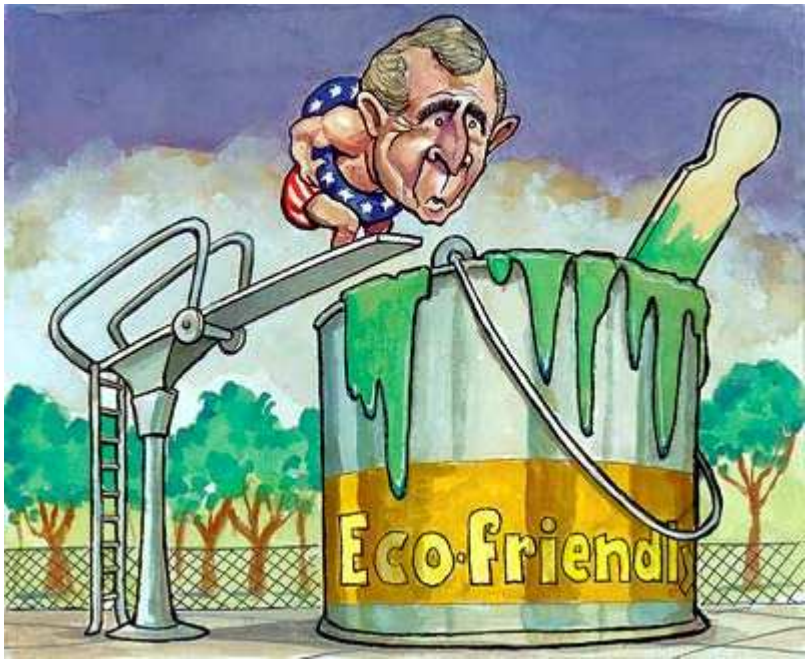
Greening Bush

Mar 3rd 2005
From The Economist print edition



An unusual, but sensible, suggestion for the homecoming president

LAST week, George Bush made a great display of changing his tone on Europe. Now that he is back on American soil, he might consider changing his tone on an even bigger subject—the environment. Embracing greenery would be good for Mr Bush, good for the Republican Party, good for relations with Europe, and, above all, good for the environment.

This does not mean signing up to the Kyoto protocol tomorrow. That would be too much to ask, and, given the incompetent design of the agreement, it would also be wrong. But it does mean going out of his way to recognise the importance of the subject. He should make it clear that his disagreements with Kyoto are more about means than ends. And he should be much noisier in championing his own brand of environmentalism—one that regards market mechanisms as the best way of improving the environment, and that treats economic growth as a long-term friend of greenery.

For many people, the idea of Mr Bush repositioning himself as an environmentalist may sound ludicrous. This is a man who made his career as an oil man and who sub-contracted his energy policy to his cronies in the energy industry. These days, Republican environmentalism is usually associated with preppie north-easterners such as Christine Todd Whitman. Steven Hayward, a green conservative at the American Enterprise Institute, points out that the environment is for conservatives what defence is for liberals: they don't feel comfortable with it.

Yet Mr Bush has a surprising amount of credibility with Main Street America on the subject. A recent Gallup/CNN/*USA Today* poll found that 49% of Americans approve of his handling of the environment. Moreover, the balance of power in the conservative movement may be changing. Some neo-cons worry about America's over-dependence on such an unstable region as the Middle East. Some fiscal conservatives worry about the impact of America's appetite for imported oil on the dollar. And some evangelical Christians worry that mercury pollution is damaging the unborn, and pointedly ask what Jesus would drive. Support for strict environmental regulation among evangelicals has jumped from 45% in 2000 to 52% last year.

In fact, today's cool relationship between conservatism and environmentalism is odd. Surely conservatism has something to do with conserving things? Conservatives like to think that they are second to none in their love of God and Country. But what could be more Godly than good stewardship of the environment? (Just consult Genesis 2:15.) And what could be more patriotic than keeping America beautiful?

Many of the founding fathers of modern conservatism were environmentalists. Teddy Roosevelt expanded the national parks. Barry Goldwater was a member of the Sierra Club. Senator James Buckley, Bill Buckley's brother, was a leading supporter of the Endangered Species Act. Ronald Reagan is often remembered for blaming trees for pollution. But he was a notably green governor of California who warned that America could no longer afford the “bulldozer mentality”.

Environmentalism also makes good political sense for Mr Bush. It fits in with his philosophy of “big-government conservatism”—his belief that conservatives should use government to promote conservative values. It helps his war against terrorism, by potentially helping to wean America from its dependence on Middle Eastern oil. And it fits in with his ambition to create an enduring Republican majority. The Republicans have successfully branded themselves as the party of growth: 97 of the 100 fastest-growing counties in the country voted for Mr Bush. But why not modify the brand to include smart growth? Plenty of suburbanites are worried about sprawl and pollution.

Clean air, clear skies

Capturing this issue from the Democrats will not be easy. But three things suggest that it is more than a fool's errand. First, the Republicans have a much better story to tell on the environment than they are given credit for, even by themselves. Gregg Easterbrook at the Brookings Institution points out that George Bush senior's 1990 Clean Air Act pioneered the use of “cap-and-trade” rules to reduce the amount of sulphur dioxide that coal-fired power plants emit. (Cap-and-trade rules establish targets for reducing pollution, but leave companies to decide how to meet those targets, including trading permits.) The result has been a substantial decline in emissions of the harmful chemicals. Mr Bush's Clear Skies Act proposes to use this cap-and-trade approach to cut the amounts of sulphur dioxide, nitrogen oxides and mercury emitted by power plants by 70%.

The environmental establishment thinks little of the Clear Skies Act. But it is in a sorry state. The Democratic Party is in danger of becoming associated with “command and control” legislation that is hard to enforce and subject to time-wasting litigation. Younger environmentalists want the movement to stop acting as a single-issue pressure group (which makes sense) and start making common cause with the wider “progressive” movement (which could be political suicide).

Mr Bush should also recall that Richard Nixon had an even harder-boiled image. Yet he was quick to embrace the new green cause. He created the Environmental Protection Agency, passed a slew of environmental legislation such as the Clean Air Act, and created more than 600 parks. Perhaps Mr Bush can learn from Mr Nixon's dexterity.

The emergence of a Republican environmentalism would not only be good for the party, but for the environment. The current monopoly of the subject by the Democrats is a triple disaster. It institutionalises policymaking gridlock. It marginalises environmental concerns. And it stultifies useful thinking. The greening of conservatism is a revolution waiting to happen.

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Brazil

The dangers of tax and spend

Mar 3rd 2005 | SÃO PAULO
From The Economist print edition

The economic dangers of Lula's largesse

Get article background

AFTER two years as Brazil's finance minister, Antonio Palocci must feel like saying “I told you so.” Critics had said that tight fiscal policy, coupled at first with high interest rates, would cripple the economy. Instead, this combination first smacked down inflation in 2003 and then delivered economic growth of 5.2% last year, the fastest pace in a decade. Mr Palocci convinced creditors that Brazil would pay its colossal public debt. That promise, plus an export boom, triggered a dramatic fall in risk premiums on Brazilian bonds and helped domestic interest rates to decline. Now Brazil has the luxury of deciding whether or not to renew an accord with the IMF which expires this month.

But success has presented Mr Palocci with new problems and a new set of critics. Inflation is again a worry, real interest rates—already among the world's highest—are again on the rise and Brazil's currency, the *real*, has strengthened to the point where it may undermine exports. The criticism is that budget policy is doing too little to restrain demand and inflation, which means that interest rates are higher than they need to be. It is “a bad policy mix”, says Eliana Cardoso, an economic pundit. This time, the critics have a point.

This is ironic. Mr Palocci started out by tightening fiscal policy even more than the IMF wanted, setting the target for the public sector's primary surplus (ie, before interest payments) at 4¼% of GDP. Last year, the government beat the target, with a primary surplus of 4.6%. But the headline number hides two problems. First, it was achieved not by streamlining government but by harvesting the extra revenue that comes with growth. The tax burden has reached an intolerable

37% of GDP. Second, the government missed an opportunity to tighten policy even further while growth was strong. Brazil needs “a much higher primary surplus”, says Paulo Leme of Goldman Sachs, an investment bank.

The fault lies with Mr Palocci's boss, President Luiz Inácio Lula da Silva, who has responded better to crisis than to opportunity. Non-financial spending by the federal government rose by 11% in real terms last year, with big rises in areas that do nothing to strengthen long-term growth prospects. Lula added workers to the federal payroll, one reason why spending on personnel rose by 5% last year. Keeping an old promise, he will raise the official minimum wage by 8% to 300 *reais* ($115) a month, which will push up the cost of publicly financed pensions and benefits by 4 billion *reais* a year, says Raul Velloso, a budget expert in Brasília.

Yet the government is proposing a looser fiscal policy for 2005. With the blessing of the IMF, it plans to lower its primary surplus target to 4.1% of GDP, and spend the extra money on investment projects, such as upgrading roads. No one doubts that Brazil needs to open up bottlenecks that undermine its competitiveness. But to raise the money by cutting the primary surplus is “a step in the wrong direction”, says Mr Leme.

For now the cost of that misstep looks low. Speculators are dazzled by a benchmark interest rate of 18.75%. In any case, Brazil tends to beat its fiscal target: in January the surplus hit 5.5% of GDP. Last week the government said that it would chop a massive 16 billion *reais* off this year's budgeted spending in order to hit the target. Debt, which dropped sharply as a share of GDP last year, is likely to decline further, albeit at a slower pace, in 2005.

Yet some Brazilians worry about what would happen if investors lose their current appetite for risk. They reckon the government should be moving to cut its debt more swiftly, allowing interest rates to fall. In a rare comment on budget policy, the central bank recently said that “reductions in public spending [would] reinforce monetary policy in controlling inflation.” The latest data suggest that the economy is already slowing, which may mean that the bank can soon stop raising rates.

But that will not silence a growing clamour for lower taxes. On March 1st Congress forced the government to delay new tax rules that seek to shift some of the burden from salaried employees to self-employed professionals and farmers. Brazilians have traditionally complained that the government spends too little on everything but debt. Now, says Joaquim Levy, a senior official at the finance ministry, they want to have a “focused, efficient state”.

That state will be a long time in the making. The government's aim is to hold federal revenue to its 2002 level of 25% of GDP. Social security will require another difficult round of reform, such as an increase in the retirement age. Mr Levy thinks the first step is to make the system more efficient, “to see better what you have to reform.” He is similarly cautious about making the budget more flexible by reducing earmarking, which puts 80% of federal spending beyond government control. “Monitoring and evaluation” of spending are “more important”, he says.

The agreement with the IMF to allow extra infrastructure investment of about $3 billion over three years reflects a similar preference for upgrading over downsizing. The projects will raise Brazil's growth potential, but the real pay-off will be new ways of planning and evaluating public investment, says Mr Levy. That may be good enough for the IMF and for the financial markets, in their current forgiving mood. But if Mr Palocci wants to ensure continued success, it is time for him to sharpen his axe.

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Uruguay's new president

Talking left abroad

Mar 3rd 2005 | SÃO PAULO
From The Economist print edition

Walking to the centre at home

TABARÉ VÁZQUEZ, Uruguay's new left-wing president, is already an historic figure. His inauguration on March 1st ended more than 150 years of government by two of the world's oldest political parties, the Colorados and the National Party. He also looks like a fortunate one. Uruguay's economy grew 12% last year, and continues to recover from a slump. For the first time in 40 years the president's party enjoys a majority in both houses of Congress. The omens could hardly be better.

Whether or not they are borne out will depend largely on the success of Dr Vázquez, an oncologist and former mayor of Montevideo, in controlling the more radical elements of his coalition. A member of Latin America's growing fraternity of left-leaning presidents, he is likely to try to imitate Brazil's pragmatic Luiz Inácio Lula da Silva rather than Venezuela's populist Hugo Chávez. The new economy minister, Danilo Astori, is a moderate who backs a prudent fiscal policy and encourages private investment. He wants a new loan agreement with the IMF.

Plenty of people in Dr Vázquez's Frente Amplio (Broad Front) think differently, but he has dealt with them cleverly. José Mujica, a popular former guerrilla, is the new agriculture minister, a job with little influence over economic policy. Reynaldo Gargano, an unreconstructed socialist, will run foreign affairs. Mr Astori has stoutly resisted pressure to add leftists to his economic team and the new president has backed him.

Mr Astori still has battles to fight, especially with labour unions. The first will be over a budget for the next five years, due to be concluded in August. Public-sector workers, whose salaries were squeezed by the slump, will press for big wage rises. The government cannot afford these: Uruguay's public debt is about 90% of GDP. Instead, Dr Vázquez will offer a $100m two-year emergency programme to help people hardest hit by the slump triggered by the collapse of neighbouring Argentina.

The biggest difference may come in foreign policy. The outgoing government of Jorge Batlle was pro-American. Dr Vázquez restored diplomatic relations with Cuba, broken in 2002, on the first day of his presidency. Under Mr Batlle, Uruguay was a wayward member of Mercosur, a four-nation customs union dominated by Brazil and Argentina. He negotiated a separate investment treaty with the United States, which Congress has yet to ratify. Dr Vázquez plans to embrace Mercosur, but without alienating the United States. It will take many such feats of balance to keep his lucky streak going.

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Canada's foreign policy

Unguided missiles

Mar 3rd 2005 | OTTAWA
From The Economist print edition

Stumbling towards a new world role

Get article background

Reuters

Spreading Canadian values

FOR Canada's foreign policy, geography is destiny. Its most important tenet is maintaining good relations and mutual respect with its powerful neighbour and dominant trading partner, the United States. Most Canadians know that, but they often disagree with American policies. Twice recently Canada's Liberal government has refused to join George Bush in military ventures. Jean Chrétien, the previous prime minister, kept Canadian troops out of Iraq. Last week, the foreign minister, Pierre Pettigrew, told parliament that Canada would not take part in Washington's ballistic-missile defence (BMD) scheme for North America.

As well as being poorly received, last week's announcement was poorly handled. That was odd. Paul Martin, the prime minister, had criticised Mr Chrétien over Iraq, saying he would have given Mr Bush proper notice and explanation. Mr Martin supported Canada's participation in BMD. But many in his own party did not, and he heads a minority administration. Hence the decision not to take part.

The plan, it appears, was first to impress the Americans with an increase in military spending of C$12.8 billion ($10.4 billion) over five years, contained in the budget on February 23rd. So Mr Martin delayed telling Mr Bush of the BMD switch, or publicly laying out reasons for it. In the end, Mr Pettigrew broke the news to his counterpart, Condoleezza Rice, by phone when both were in Brussels for a NATO summit.

Since 1958, Canada has been a partner in the North American Aerospace Defence Command (Norad), whose object is to detect and destroy incoming aircraft or cruise missiles. Last year, Canada agreed that Norad should extend to ballistic missiles. So Mr Martin said that he still expects to be consulted before any American interceptor missile is fired over Canada.

That is unrealistic. America's ambassador in Ottawa said that last week's decision means that Canada has, in effect, surrendered sovereignty over its airspace. The affair adds to a sense in Washington that Canada hardly matters in the world. Canadians are “free riders” who know “Americans will always come to their rescue”, said a *Wall Street Journal* editorial.

Yet Mr Martin does want Canada to play a more active role abroad in other ways. The increase in military spending was designed in part to assure America that Canada is increasing its effort to fight terrorism and secure the common border. Much of the money will be spent on raising 5,000

soldiers for a rapid-response brigade, which might add muscle to Mr Martin's support for humanitarian interventions in failing states.

More may be revealed in the long-delayed conclusions of a foreign-policy review. One controversial idea being touted is to form a “Canada Corps” to undertake missions that promote good governance and human rights in distant lands. To some Canadians that seems awkwardly similar to Mr Bush's crusade to spread freedom. The budget included a promise to double aid to Africa to C$2.8 billion by 2009, though arguments continue as to how this should be spent. Another of Mr Martin's ideas is to set up a 20-country group bringing together the leaders of large emerging countries and the G7 group of rich countries. Mr Bush may now be even less keen to back this idea.

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Mexicans abroad

The vote next time

Mar 3rd 2005 | MEXICO CITY AND CHICAGO
From The Economist print edition

Willing the end but not the means

Get article background

AP

Take me to the polling station

SOME 5m adult Mexicans are thought to live in the United States. Plans to allow them to vote in presidential elections back home have circulated in the corridors of power in Mexico City for the best part of 20 years. To not much effect, it seemed—until now. On February 22nd, the lower house of Congress voted overwhelmingly to amend the federal electoral code to allow voting to take place abroad. Since every political party, as well as President Vicente Fox, backs the change, the decision provoked an outburst of euphoria and some mutual back-slapping among the normally squabbling deputies.

This week came the hangover. The measure has now passed to the Senate. It is not likely to emerge from there soon. That is not because it faces opposition, but more because a host of details remain to be sorted out. So it is unlikely that the change will come into effect in time for the presidential election next year.

The practicalities are indeed daunting. What Mexico hopes to organise is the world's biggest-ever émigré ballot. But the lower house did little to clarify exactly how this might be done. It dumped responsibility for working out the details on to the Federal Electoral Institute (IFE). This body has enough on its hands trying to organise next year's election in a country with a long (though much diminished) tradition of electoral fraud. The amendment offers the institute just 200m pesos ($18m) of extra funding. Other estimates of the cost of registering voters, setting up some 5,000 polling stations in the United States, training staff and co-ordinating all this with American officials, start at 3 billion pesos. That sort of money seems unlikely to be forthcoming.

Mexican-American pressure-groups have long been pushing for the vote. Florencio Zaragoza, of the Coalition for the Political Rights of Mexicans Abroad, welcomed the amendment. But he argues that even if unlimited cash were available, the time available to make the necessary changes before the 2006 election is already short. Unless the amendment clears Congress in its current session, which ends in April, it will be too late to have any effect until the following election, in 2012.

The Senate will also have to consider legal complications. Would Mexico's electoral code be applicable in the United States—for instance, in case of voter fraud in Chicago or New York? And in the current climate of growing hostility to Mexican immigrants in many parts of the United States, would American taxpayers be willing to foot the bill for policing hundreds of thousands of people voting for an election in another country? Another issue yet to be settled is whether the IFE should

attempt to arrange voting across the United States. Some suggest that it would be more practical to place polling stations only in cities with more than 15,000 Mexicans registered as voters.

Mr Fox had proposed to restrict voting abroad to Mexicans who already have electoral registration cards and who live in four cities in the United States. By broadening this simple plan, the opposition may have delayed its implementation. So, for all the celebration, the lower house's decision looks largely symbolic. Those expatriates who want to vote next year will probably have to return to Mexico to do so, as they have in the past. And since many fear they would not be allowed back into the United States, few do.

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Haiti

Imaginary nation

Mar 3rd 2005 | MIAMI
From The Economist print edition

A year of painfully slow progress

Get article background

A YEAR ago this week, an armed rebellion forced Jean-Bertrand Aristide to step down as Haiti's president, triggering yet another outside attempt to build a nation in the poorest corner of the Americas. A year on, Haiti is no longer on the brink of civil war. But otherwise there is not a lot to show for the effort.

The first problem remains security. Armed gangs still control several of the capital's sprawling slums. Former soldiers who led the uprising against Mr Aristide have refused to hand over their guns. United Nations peacekeepers had appeared to be getting a grip on the streets. But violence flared again around the anniversary.

Part of the problem is an undermanned, partisan and brutal police force. This week, police opened fire on protesters marking the anniversary of Mr Aristide's fall, killing at least two (and perhaps five). UN troops witnessed, but failed to prevent, the incident.

A fortnight ago, 481 inmates escaped from the main prison after it was attacked by six gunmen who burst through its gates. Two jailed former ministers walked home for their own safety, turning themselves in again after a dinner of cheese and wine. Among those who got away was Jean-Claude Louis-Jean, a businessman suspected of ties to the rebellion and the drug trade. Some prisoners were quickly rounded up again in police raids in the slums, in which several people were killed. The ease with which the break-out happened led to claims of police complicity.

In all, some 400 Haitians have died in the past six months. Ending the violence is urgent. The UN plan calls for elections for a new president and congress at the end of this year, to replace the weak interim government. As in Iraq, it will be tough to organise credible ballots while much of the country is under the control of illegal armed groups.

There is no sign of political reconciliation between supporters and opponents of Mr Aristide. It would help, too, if the economy was reviving. But aid has been slow to arrive, partly because the government has yet to present credible plans for a promised public-works programme. The World Bank disbursed $46m in budget support in January and opens an office in Haiti next week. Security worries have scared off other donors. Officials say job-creation projects will shortly get off the ground. It can hardly be too soon.

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Economist.com WORLD ASIA

Hong Kong

Time runs out for China's loyal servant

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AP

If only, say Hong Kong's democrats, the system were scrapped as well as the man

TUNG CHEE-HWA, Hong Kong's chief executive, has got a new appointment after nearly eight undistinguished years as the territory's first post-colonial leader. The job is not one he will be excited about. He has been named as an adviser to China's parliament, a position often handed out as a sinecure for retired officials. The question is whether this means that he will quit his day job—as hundreds of thousands of demonstrators have been urging for the past two years (a protest, with Mr Tung as balloon, is shown above).

He probably will, or indeed has. Chinese and Hong Kong officials have studiously avoided denying media reports this week that he has already submitted his resignation. An official announcement might possibly be delayed until March 12th, the day when he will be appointed vice-chairman of the advisory Chinese People's Political Consultative Conference. Mr Tung has served on this body before, but stepped down in 1997 when China appointed him Hong Kong's first chief executive after Britain's withdrawal.

Mr Tung has proved a singularly ineffective leader almost from the start. As a shipping magnate whose firm owed a lot to Chinese financial help, he recommended himself through his loyalty rather than his skills. And his lack of political acumen and administrative experience have shown up again and again in critical moments, from the Asian financial meltdown in 1997 to the outbreak of SARS in 2003 to recent popular demands for democracy.

Though not personally to blame, Mr Tung also presided over six years of deflation and the sharpest house-price fall in living memory. While Hong Kong's economy has recovered sharply over the past 18 months, his poll ratings have not.

It was not, though, until after half a million people took to the streets in July 2003, protesting against a Beijing-mandated anti-subversion law (which as a result was shelved), that the mainland's top leaders began to realise just how unpopular and ineffective their man was. Last December, Hu Jintao, China's president, publicly criticised Mr Tung for his failings.

But the timing of Mr Tung's departure still looks curious. He has always insisted that he will serve out his full second term, which ends in 2007. So why should China let him go now? It may feel more confident that it has found someone it can trust to take over. The frontrunner is Mr Tung's chief secretary, the dapper bow-tie-wearing Donald Tsang. China may have had misgivings about Mr Tsang's closeness to the British in colonial days (he was awarded a knighthood). But Mr Tsang has hewed closely to China's line in his handling of public demands for more democracy, while showing a great deal of political savvy in presenting China's unpopular policies to the public.

China may also have calculated that the 800-strong body of Hong Kong grandees which selects the chief executive, and which obligingly and overwhelmingly voted in favour of Mr Tung not just once but twice, is due to be dissolved in July. Selecting a new and equally compliant bunch against the current background of popular democratic sentiment could prove a bit trickier.

And by choosing a new chief executive now, who would remain in office for another five years, Hong Kong and Chinese officials could put off having to decide how to make this “election committee” more democratic, as they had promised to do by 2007. Hong Kong law dictates that new elections take place 120 days after the resignation of a chief executive. A speedy election would give those who had been thinking of competing in 2007 very little time to mount an effective campaign.

Mr Tsang automatically becomes the interim chief executive if Mr Tung steps down. In a city that scrutinises every move by China, a six-second handshake given by Mr Hu to Mr Tsang in December was seen as a sign that he was China's choice to be confirmed in the post.

Mr Tsang has proved more than just loyal. He has also proved competent. As financial secretary during the height of the 1997 financial crisis, he organised a government-sponsored fund that poured public money into the stockmarket. At the time, private investors were selling in the belief that Hong Kong would have to abandon its currency peg to the dollar. Not only did the peg hold, but the government made windfall profits when share prices recovered.

Should Mr Tung be replaced, Hong Kong's democrats will find themselves in a quandary. The man who in their view so embodied what was wrong with Chinese rule in Hong Kong will have gone, not least because of pressure from the public. But Martin Lee, a legislator and former leader of Hong Kong's biggest pro-democracy party, the Democratic Party, says Hong Kong's 7m citizens should not be celebrating. “Beijing should have changed the system, not the man,” he says.

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Economist.com WORLD ASIA

India's budget

In black and white

Mar 3rd 2005 | DELHI
From The Economist print edition

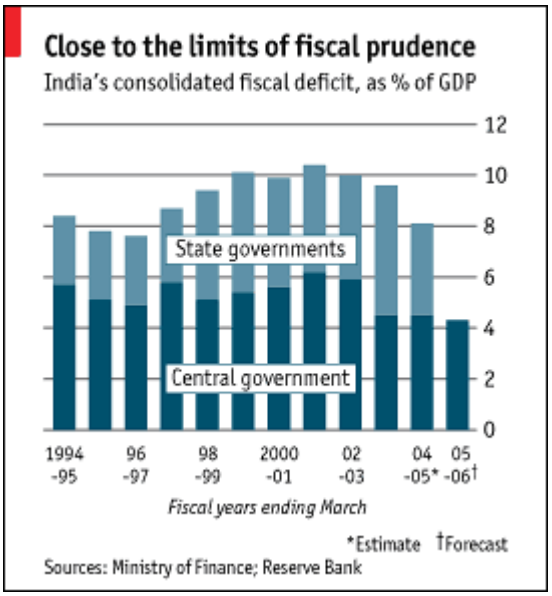
An opportunity for bold reform spurned by India's finance minister

IF YOU have produced what you think is a great work of art, it is galling when spectators nitpick over minor details and ignore the grand design. Palaniappan Chidambaram, India's finance minister, having delivered his two-hour budget speech on February 28th, seemed irked that most attention focused on just one proposed measure. This would impose a tax of 0.1% on cash withdrawals from banks of more than 10,000 rupees ($230) in any one day. The minister's questioners had a point: the idea is both important and odd.

Its intention is to deter tax evasion. A huge amount of business is transacted in the “black” economy, in stapled wads of banknotes. Cars and even houses are sometimes bought this way, enabling the seller not to declare his income from these sources to the taxman. That is one reason why, as Mr Chidambaram lamented, only 75,000-80,000 taxpayers have declared annual incomes of more than 1m rupees. So he wants to “push people into the cheque economy”, where their spending leaves an audit trail.

Fiddling round the taxman

As many people have pointed out, taxing “white” money, making banking unattractive, encouraging 9,999 rupee withdrawals and giving an unreliable taxman further opportunities for discretion and harassment may not be the best way to go about this. However, one of the government's most pressing needs is to raise tax revenues without discouraging investment. After 15 years of rapid economic growth, tax receipts in India are smaller, as a percentage of GDP (under 10%), than they were in the late 1980s.



The big challenge facing any Indian finance minister is that, as this one put it, the country is "perilously close to the limits of fiscal prudence". This government, led by the Congress party elected last year, faces huge pressure to fulfil its promises to lavish money on agriculture, infrastructure, education and health care. But it suffers a massive fiscal deficit (see chart). Though the deficit came down somewhat in the past year and is forecast to do so again in the coming year, foreign credit-rating agencies were disappointed that Mr Chidambaram has, in his words, "pushed the pause button" on meeting the deficit-reduction targets imposed by a law passed in 2003. They argued that now, while the economy is growing rapidly—by around 7% last year and this one—it would be far easier to make difficult choices than later in this economic cycle.

Politically, too, this, the first full-year budget presented by the government may have been the best chance to make difficult fiscal decisions. Many people are still prepared to give it the benefit of the doubt. Next year policymaking will be complicated by state elections in West Bengal and Kerala, in which the Congress party will be competing with its Communist allies whose support it needs to muster a parliamentary majority in Delhi. By 2007, such is the cycle of Indian politics, the finance minister's mind may already be on the next general election.

As it was, Mr Chidambaram was given credit both by the left, for doing his best to meet his spending promises, and by those keen to see faster economic reform, for his tax cuts, deregulation measures and promises to consider further opening of the economy. But both groups were disappointed he had not gone further, and the minister must know that he cannot rely for ever on growth strong enough to allow him to have it both ways.

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India's state elections

Stalemate

Mar 3rd 2005 | DELHI
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Electoral deadlock in a big state means trouble at the centre

IN MOST Indian states, forecasting election results is easy: incumbent governments lose. Bihar, with its 83m people, has long been an exception. For 15 years it has continued under the rule of the Rashtriya Janata Dal (RJD) party, led by Laloo Prasad Yadav, championing the cause of the state's lower-caste and Muslim voters.

In the process, Bihar has become a byword for poverty, crime and corruption, while the RJD has become an important national force. With 24 seats in the parliament in Delhi, it is the second-largest constituent of the coalition government, led by the Congress party, which took power last year.

In election results announced on February 27th, however, the RJD got its partial come-uppance. It won just 75 of 243 seats in the state assembly, down from 115. An opposition alliance won 92. Neither, so far, can form a government. The balance of power lies with the 29 seats held by the Lok Janshakti Party (LJP), of Ram Vilas Paswan, a leader of India's *dalits* (formerly called "untouchables"). Mr Paswan refuses to support either the opposition or Mr Yadav, a fierce local rival.

Since the LJP is also part of the coalition government in Delhi, this is awkward for the Congress party. Mr Paswan wants it to impose "president's rule", ie, direct government from Delhi. That, however, would risk angering Mr Yadav, who is railways minister in the central government. He still believes he can wheedle enough independents and others into his camp to prolong his rule in Bihar (or rather, that of his wife; he himself stood down as chief minister in 1997, a time when he was facing formidably serious corruption charges).

The dilemma highlights a broader danger both to Congress and to the Bharatiya Janata Party (BJP), its main challenger for national power: in many states they are minority parties. In Bihar, Congress won only ten seats, against the BJP's 37. In simultaneous elections held in Jharkhand, a state hived off from Bihar in 2000, Congress won nine of the 81 seats and the BJP 30 (though in the end, a Congress ally managed, amid noisy allegations of shady dealing, to cobble together a majority). In the third election result announced on the same day, in Haryana, Congress won by a landslide, but Haryana has only ten seats in the national parliament, compared with Bihar's 40.

This helps to explain why president's rule, which has obvious attractions in such a misgoverned state, is difficult so long as Mr Yadav opposes it. Push him too far, and Congress's coalition will look shaky. It might even revive talk of a "third-front" government, excluding the two big parties.

The consolation is that many of the leaders of the smaller parties, such as Mr Paswan and Mr Yadav, seem to hate each other even more than the upper-caste oppressors that they rail against.

Indonesia's economy

Promises, promises: at last something seems to be happening

Mar 3rd 2005 | JAKARTA
From The Economist print edition

But Indonesians have yet to be convinced that cutting fuel subsidies is a good idea

Reuters

Jumping with anger at the fuel-price rise

Get article background

ON MARCH 1st, after much deliberation, the Indonesian government finally reduced subsidies on various fuels, raising the price of petrol by roughly 30%. Economists had been anxiously waiting for this ever since Susilo Bambang Yudhoyono became president in October. After all, the government was spending more on fuel subsidies than it was on health and education put together; during the election campaign, Mr Yudhoyono had given clear warning that change was needed. Yet he and his economic team agonised for months over the scale and timing of the move—thus raising doubts about how quickly they will go on to overhaul South-East Asia's largest economy.

What he said he would do

On the campaign trail, Mr Yudhoyono had proposed two broad economic strategies, both designed to help poorer Indonesians. The first involved diverting government spending from wasteful measures, such as the fuel subsidies, towards targeted development programmes, especially in the neglected rural areas where the majority of Indonesians live. The other main theme was job creation, to be brought about by reducing corruption and encouraging investment. He promised to take dramatic steps within his first 100 days in office. But by the time the deadline passed, in early February, the government had little to show for itself beyond a well-attended conference for potential investors in Indonesia's infrastructure.

The list of what hasn't happened is a bit depressing. Despite Mr Yudhoyono's increasingly strenuous denunciations of corruption, prosecutors have not yet unveiled any big new investigations. Instead, they have become embroiled in a row with parliament over whether the attorney-general's office is really “a village of thieves”, as one legislator asserted. The president has not yet fleshed out his talk of rural development. And the government has been slow to resolve a series of disputes with foreign investors that are reinforcing the notion that Indonesia is an unpredictable place to do business.

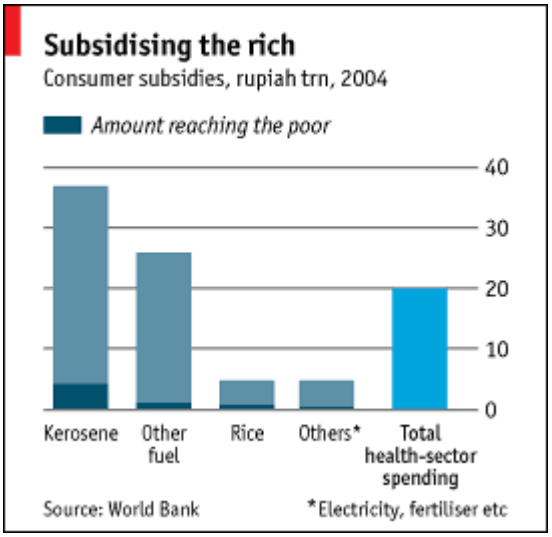
The planned privatisation of a state-owned cement firm has stalled mid-sale. The government has ignored international arbitrators who ordered it to pay compensation to Karaha Bodas, an energy firm, and has slapped it with a big tax bill instead. Other rows, involving mining and oil companies, continue to fester.

To be fair, Mr Yudhoyono has had to put other business on hold while responding to December's tsunami, an event he could not possibly have prepared for. Even before the tsunami struck, the fasting month of Ramadan and a series of holidays had got his government off to a slow start. In any case, Mr Yudhoyono never claimed to be a snappy decision-maker. He paints himself as more of a deep thinker, interrupting his election campaign to finish a doctorate in economics.

Moreover, neither element of Mr Yudhoyono's strategy is easy to implement. A serious counter-corruption drive will meet stiff resistance from crooked politicians and bureaucrats. The fuel-price rise is hugely unpopular. Protesters have already turned out in front of the presidential palace, an unwelcome reminder of the previous government's attempts to raise prices in 2003, which culminated in demonstrations and an embarrassing reversal.

Mr Yudhoyono has tried to soften the blow by detailing the extra social spending, worth 10 trillion rupiah ($1 billion), that the price rise will permit. He has also ruled out any increase in the price of kerosene, which the poor, along with many restaurateurs, use for cooking. The government is even running television advertisements in which a tycoon's driver explains to fellow workers how the benefits of subsidies flow mainly to the rich, since they consume more fuel.

Internal divisions seem to be adding to the government's difficulties. The economics team is an uncomfortable mix of technocrats and politically-connected businessmen; ministers often speak out of turn or at cross-purposes.



Whereas Mr Yudhoyono stresses the need to help the poor and reduce corruption, Jusuf Kalla, the

vice-president and point man on the economy, puts more emphasis on stimulating bank lending and improving the infrastructure. Jakarta is rife with rumours that the two men are clashing over the appointment of almost every government official, although Mr Kalla insists that they are getting on fine.

Despite this muddle, the economy is ticking along nicely. It grew by 5.1% last year, the fastest rate since the Asian financial crisis of 1997. Investment, which had been lagging badly, is also rising to cater to a consumer boom. The budget deficit came in at a manageable 1.3% of GDP last year, and will be lower this year, thanks in part to the reduction in subsidies. But these figures are flattered by a recent rejigging of the base from which economic growth is calculated. Other countries in the region, such as Malaysia and the Philippines, are growing even faster.

Mr Yudhoyono wants the economy to grow by 7% or more, to generate enough jobs to start absorbing Indonesia's legions of unemployed. Fauzi Ichsan, an economist at Standard Chartered Bank, argues that that will not happen until investment picks up in export industries, as well as in those catering to domestic consumers. But Dennis Heffernan, of Van Zorge Heffernan, a local consultancy (and affiliated to the Economist Intelligence Unit, our sister company), says that foreign businessmen are still wary of Indonesia's capricious legal system, and are waiting on the sidelines to see if the new government really does crack down on corruption. More tough decisions await Mr Yudhoyono.

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Economist.com WORLD ASIA

Malaysian immigration

An amnesty of sorts for illegals

Mar 3rd 2005 | BANGKOK
From The Economist print edition

But many ignored it, and are being punished

Get article background

EARLY on the morning of March 1st, a team of 500 immigration officers and volunteers encircled a building site on the outskirts of Kuala Lumpur. They were looking for illegal immigrants, who had ignored the rules of a four-month amnesty and refused to leave the country by midnight the night before. The 62 undocumented workers they found now risk a spell in jail, a fine, and six lashes with a rattan cane, before being deported. The government says it has 300,000 volunteers standing by to join in raids to try to root out every last undesirable alien.

Harsh as all that sounds, there are signs that Malaysia is beginning to take a more rational approach to migrant labour. It has been fighting a losing battle against illegal immigration for years. Its income per head is roughly three times that of neighbouring Indonesia; its unemployment rate, about a third. Poor Indonesians cannot resist the lure of a steady job, while Malaysians are not much interested in ill-paid, uncomfortable work as manual labourers.

Cumbersome and expensive immigration procedures make it difficult for migrant workers to enter legally. But the long and porous land and sea borders between the two countries, not to mention a common language and culture, make it easy for Indonesians to slip in unofficially. No wonder, then, that estimates of the number of Indonesians working illegally in Malaysia range as high as 1m.

The last time the government tried to crack down, in 2002, hundreds of thousands of Indonesians flocked home, to be housed in insanitary and overcrowded camps, where dozens died. But Malaysia's zeal soon waned, and migrant workers quickly returned.

This time around, there are hints of a more rational approach. During the amnesty illegal immigrants could register to legalise themselves. They were still required to leave the country, but given priority when applying to return, which they can do at 12 centres set up for the purpose in Indonesia. The government has also announced that it is considering allowing foreigners to work in restaurants and shops, as well as factories, farms and building. Almost 400,000 undocumented workers took advantage of the offer and left.

But many more could not afford to—not least because some firms took advantage of the crackdown to withhold their pay. When Thailand began a similar registration drive last year, it gave illegal workers an incentive to turn themselves in, by offering those who did a year's leave to stay. Some 1.2m Burmese, Cambodians and Laotians signed up, and are now, in theory, protected by Thai labour laws.

In practice, says Dennis Arnold of the Thai Labour Campaign, a pressure-group, firms still pay migrant workers far less than the minimum wage, knowing that few will complain. He points out that Mae Sot, a city where 100,000 Burmese migrants work, has only a single labour-protection

officer, who works one day a week. Nonetheless, last September a Thai court ordered a recalcitrant textile firm to pay 1.2m baht (about $30,000) in back pay to 18 Burmese workers. Other cases are pending.

In the end, both the countries that send migrant workers and the ones that receive them benefit enormously. Filipinos working overseas sent $8 billion home last year, roughly 9% of the country's national income. The presence of 500,000 foreign workers, who make up a fifth of the workforce, has helped to propel Singapore's breakneck economic growth. And businessmen in Malaysia are already complaining about a dearth of cheap labour.

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Economist.com WORLD ASIA

Japan's sex trade

Entertainment, of a kind

Mar 3rd 2005 | TOKYO
From The Economist print edition

Making it harder to abuse younger, prettier immigrants to Japan

AP

Singing and dancing not required

THE message for immigrants is mixed. Most are not welcome. But Japan's government tends to look the other way when criminal gangs bring in young migrants to work in the country's sex industry. Over the past year, however, the government has begun taking a rather tougher stand with those who import foreign women and then bully them into the industry through debt-bondage and other forms of coercion.

From March 15th, Japan will impose strict limits on the issuing of entertainment visas. A notorious source of abuse, these visas allow sex businesses to import women with little talent for song or dance from South-East Asia (especially the Philippines), eastern Europe and elsewhere. Last week bills were submitted to parliament which, if passed, will allow for stiffer fines and penalties, and make it a little easier to impede traffic in sex-workers.

A new government attitude, if genuine, would certainly help. Official apathy, and sometimes complicity, have long been part of the problem. In an interview this week in the *Asahi Shimbun*, a big daily, the head of Tokyo's regional immigration office, Hidenori Sakanaka, accused unnamed lawmakers of helping to protect the businessmen and criminal gangs behind the sex trade. Mr Sakanaka chastised “weak-kneed” immigration officials for looking the other way; he could also have blamed the police, who sometimes return escaped sex-workers to their captors.

Most of the public, however, do not seem to share Mr Sakanaka's outrage. Many regard foreign sex-workers as simple economic migrants, who have courted trouble by entering Japan in the first place. Most of the pressure for change, therefore, has come from abroad.

The United States has been especially scathing. Last summer, it put Japan on its human-trafficking watchlist, and gave warning that it was not far from being lumped in with North Korea and Myanmar. On February 28th, when the State Department issued its latest country reports on human rights, it again pointed to the Japanese government's failure to protect sex-workers.

The International Labour Organisation (ILO) has also been fiercely critical of Japan. It issued a report in November highlighting the government's cruel indifference towards the victims of human trafficking. When officials do come across immigrant sex-workers, said the ILO, they tend to deport them as lawbreakers instead of giving them any protection.

The criticism is having an effect, and the curtailment of entertainment visas will dent the problem. But it is not yet clear how many of the other changes are cosmetic. Although the government has

no law specifically targeting the sex trade, it has set up an inter-ministerial group to co-ordinate the efforts of the police, immigration officials and others. But holding seminars and issuing directives is a far cry from hunting down criminal gangs and breaking up their networks. Foreign pressure will be needed for quite a while yet.

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Rebuilding failed states

From chaos, order

Mar 3rd 2005 | FREETOWN AND MONROVIA
From The Economist print edition

Reuters

What can the world do about state failure? Surprisingly, quite a lot

Get article background

ONE and a half years ago, Liberia was a failed state. Two separate groups of drug-emboldened teenage rebels controlled most of the country. A gangsterish president, Charles Taylor, was losing control even over Monrovia, the capital, where all sides were firing heavy artillery into office blocks and looting strategic spots such as the brewery. In August 2003 (see article), *The Economist* reported from that unhappy city that "famished townsfolk have already eaten their neighbours' dogs and are reduced to scrounging for snails."

Today, thanks to the world's largest UN peacekeeping force, Liberia is calm. Some 15,000 blue helmets are keeping the streets more or less safe. There are still road blocks, but not the old sort, where militiamen stretched human intestines across the road as a signal to motorists to stop and be robbed. The UN road blocks are typically manned by disciplined Bangladeshis, of whom the locals vocally approve.

"They are very nice," says Richard Dorbor, an office assistant in Buchanan, Liberia's main port. During the civil war, rebels looted the town clean: Mr Dorbor points to the dark patch on the wall where the kitchen sink used to be. But then the Bangladeshis came, overawed them and disarmed them, without a single casualty.

"In any group, there are good boys and bad boys," says Colonel Anis Zaman, the Bangladeshi

commander in Buchanan, relaxing in cricket whites on a Sunday. “With the bad boys, you have to be firm. You say: ‘If you want to be funny, look at our APCs [armoured personnel carriers] and machineguns. We can be funny, too. So let's just put down the guns and talk.’”

Scholars cannot agree how to define a failed state, but most concur that state failure is one of the world's gravest challenges. The World Bank frets about 30 “low-income countries under stress” (LICUS). Britain's Department for International Development (DFID) worries about 46 “fragile” states.

This article is concerned with the toughest cases: states that have lost control over most of their territory and stopped providing even the most basic services to their people. Only Somalia unambiguously fits this definition. A larger group of countries, mostly in Africa, are close to failure (see chart). Some, such as Zimbabwe, are cantering towards a cliff-edge. Others, having recently failed, appear to be recovering, if fitfully: Afghanistan, Haiti, Sierra Leone and Liberia all fall into this category.

Candidates for failure

Selected “Low-income countries under stress”, as defined by the World Bank

	Population m	GDP per person 2002, $	Average annual GDP, % change, per person, 1990-2002	Conflict since 1990
Afghanistan	29	*	*	✔
Angola	14	710	-0.1	✔
Burundi	7	100	-3.9	✔
Cambodia	13	300	4.1	✔
Central African Republic	4	250	-0.2	✔
Congo, Democratic Republic	53	100	*	✔
Congo-Brazzaville	4	610	-1.6	✔
Guinea-Bissau	2	130	-2.2	✔
Haiti	8	440	-3.0	✔
Laos	6	310	3.8	✘
Liberia	3	140	*	✔
Myanmar	49	*	5.7	✔
Nigeria	136	300	-0.3	✔
Papua New Guinea	6	530	0.5	✘
Somalia	10	*	*	✔
Sudan	34	370	3.1	✔
Tajikistan	6	180	-8.1	✔
Togo	5	270	-0.7	✘
Uzbekistan	26	310	-0.9	✘
Zimbabwe	13	480	-0.8	✘

Source: World Bank

*Data not available

States can fail because of external shocks, or they can decay from within, or both. Afghanistan and Angola collapsed when their colonial overlords suddenly withdrew. In Sierra Leone and Congo, the state was looted into putrescence, thus inviting rebellion and ultimately, collapse.

It is tough to mend a failed state, but the fact that some formerly failed states are now doing quite well—eg, Mozambique and East Timor—shows that it is not impossible. And although treatment is costly—the UN mission in Liberia costs $800m a year—the cost of doing nothing is often higher.

When governments collapse, it is not only bad for citizens who thereby lose the law's protection. It can also cause regional or even global repercussions.

Lawlessness, it is often argued, creates space for terrorists to operate. This is sometimes true: there are almost certainly al-Qaeda operatives lurking in Somalia and the wilder parts of Pakistan. But the most-cited example, Afghanistan, does not really support this argument. Osama bin Laden used Afghanistan as a base not because it was a failed state, but because its government invited him to.

State failure is contagious

The chief reason why the world should worry about state failure is that it is contagious. Liberia's civil war, for example, infected all three of its neighbours, thus destabilising a broad slice of West Africa. Congo's did the same for Central Africa.

Lisa Chauvet and Paul Collier of Oxford University have tried to measure the cost of a typical poor country becoming a LICUS, ie, as unstable as Nigeria or Indonesia, but nowhere near as bad as Liberia. They added together an estimate of growth forgone because of instability and an estimate of the spillover effect on neighbouring countries, and arrived at the startling figure of $82 billion.

Since this is more than the world's entire annual aid budget, it suggests that even costly interventions, if they help to stabilise a failing state, are likely to be worthwhile. Looking only at war-torn states, Mr Collier and Anke Hoeffler, also of Oxford, found that three types of intervention were highly cost-effective, even before one considers the value of saving lives.

One good idea is to try to restrict the sales of commodities that fuel war. Extractable minerals often provide both the means to fight and an incentive to do so: rebels in Sierra Leone, for example, dug diamonds to pay for arms, and fought to seize power so they could grab all the mines. A global embargo on “conflict diamonds” has reduced the flow of cash to similar rebel groups, thereby probably foreshortening a war or two at minimal cost.

Another worthwhile tactic is to offer generous aid to war-flattened countries, once they have stabilised a bit, so that they can rebuild their buildings and institutions. Mr Collier and Ms Hoeffler estimated that increasing aid to post-conflict countries by the equivalent of 2% of GDP per year for five years, starting half a decade after the war ended, would cost $13 billion but yield $31.5 billion in benefits.

The most cost-effective way to stabilise a failed state is to send peacekeepers

By far the most cost-effective way of stabilising a failed state, however, is to send peacekeepers. Mr Collier and Ms Hoeffler calculated that $4.8 billion of peacekeeping yields nearly $400 billion in benefits. This figure should be treated with caution, since it is extrapolated from one successful example. In 2000, a small contingent of British troops smashed a vicious rebel army in Sierra Leone, secured the capital and rescued a UN peacekeeping mission from disaster.

Not all interventions go so well. But a study by the RAND Corporation, a think-tank, suggests that the UN, despite its well-publicised blunders, is quite good at peacekeeping. Of the eight UN-led missions it examined, seven brought sustained peace (Namibia, El Salvador, Cambodia, Mozambique, Eastern Slavonia, Sierra Leone and East Timor), while one (in Congo) did not. An earlier RAND study had looked at eight American-led missions and found that only four of the nations involved (Germany, Japan, Bosnia and Kosovo), were now at peace, while the other four (Somalia, Haiti, Afghanistan and Iraq) were not, or at any rate, not yet.

The comparison is not entirely fair. The Americans took on tougher targets: Iraq has more suicide-bombers than East Timor. On the other hand, the UN had punier forces and budgets at its

disposal. The annual cost of all 11 UN peacekeeping operations today is less than America spends in a month in Iraq.

A cautionary but hopeful tale

Liberia illustrates some of the opportunities and pitfalls for peacemakers. The country was founded by freed American slaves in the 19th century, who at times enslaved the indigenous population, but also brought laws, roads and industry to Liberia. By the 1960s, the country was one of the most prosperous in Africa.

Its descent into mayhem began in 1980, when a semi-literate master-sergeant named Samuel Doe disembowelled the president in his bed and seized power. As violent as he was corrupt, Doe scared most of the middle class into emigrating, causing the average Liberian income to plummet by three-quarters in ten years.

Charles Taylor, an opportunist who had trained as a guerrilla in Libya, started a revolt against Doe in 1989. Doe was caught and filmed being tortured to death in 1990, but the civil war continued, on and off, for another 13 years. Mr Taylor emerged as the most fearsome warlord, and was elected president during a ceasefire in 1997, after promising voters that if they spurned him, he would go back to war. His campaign slogan was: “He killed my ma; he killed my pa; I'll vote for him.”

Once in the executive mansion, he ruled like a mafia boss, grabbing a slice of every sizeable business and wasting his rivals as if they were money. He did not even pretend to provide the services that normal governments do. Asked whether he would restore electricity to Monrovia, he advised people to buy generators. His misrule provoked a fresh civil war, and he used obscene tactics to defend his turf.

“I've never seen things like this before,” says Daniel Lomboy, a Filipino policeman hired by the UN to investigate Liberian war crimes. “In one mass grave, we found [the remains of] a pregnant woman whose fetus's bones were outside her stomach but inside her dress.” Mr Taylor's men sometimes took bets as to the sex of an unborn child, he explains, and then had a look.

Eventually, Mr Taylor made too many enemies. In return for a share of the loot, he armed rebels in all three neighbouring countries. Guinea and Côte d'Ivoire retaliated by backing Liberian rebel groups. In June 2003, George Bush said it was time for Mr Taylor to go, a suggestion he underlined by parking warships off Monrovia. Nigeria offered Mr Taylor sanctuary if he came quietly and ceased to meddle in Liberian politics. He flew into exile, where he remains, still plotting.

A peace deal brought the two anti-Taylor rebel groups into a power-sharing transitional government with some of Mr Taylor's former lieutenants. The United States, the UN and Nigeria insisted that those with the most blood on their hands should not be ministers. So the government now consists of personable but weak ministers with scary deputies. Elections are scheduled for October. In the meantime, the UN is trying to make the country safe for rough-and-ready democracy.

The UN secretary-general's “special representative” in Liberia, a forceful American called Jacques Klein, is the most powerful man in the country. He may lack an “executive mandate”, including the power to arrest people, such as the UN had in East Timor, but his budget is roughly ten times larger than the Liberian government's. A UN embargo on Liberia's main exports (timber and diamonds)

remains in force, pending proof that the money is not falling into the wrong pockets.

Liberia's main railway needs a bit of work

Mr Klein put 48 Liberian “generals” (with noms de guerre such as “General Peanut Butter” and “General Fuck-Me-Quick”) on the UN payroll, so that they would help him disarm their men (and boys and girls). The ex-fighters were offered incentives to surrender their guns: $300 and help with school fees or vocational training. About 100,000 handed in weapons or ammunition, which is encouraging. But not everyone is happy.

Solomon Dennis, for example, was abducted from a scripture class when he was 13 and press-ganged into Charles Taylor's army. Now 18, he wants to resume his studies, but he complains that the school fees the UN promised him have not been paid, so he can't. Like most former fighters, who have typically learned the joys of consumerism by looting the towns they passed through, Mr Dennis is not content to go back to his village and be a peasant. In a country with almost no jobs, such desires can be dangerous.

Those who did not fight, meanwhile, think it unfair that the killers are rewarded. “They only help the bad people, not the good ones,” fumes Thomas Mambo, a former book-keeper who lost his home and job during the war and now squats with 75 other people in a blackened and gutted building that used to belong to Liberia's old ruling party, the True Whigs. “If the UN doesn't help us, we'll take up arms, too.”

Liberia is small (with a population of only 3m), accessible from the sea and blessedly free of citizens who imagine they have a sacred duty to kill peacekeepers. This may be why it has proven simpler to pacify than, for example, the vast and nearly landlocked Democratic Republic of Congo, where nine blue helmets from Bangladesh were killed last week.

Pacification is only the first step

But pacification is only the first step. To ensure that a recovering failed state does not fail again, it needs a government that is legitimate and competent enough not to invite another rebellion. And nation-building is the hardest task of all.

For an illustration of how utterly the Liberian state has decayed, consider the once-busy port at Buchanan. The railway that once brought iron ore there from an inland mine has been swallowed by the bush. The iron-ore processing depot on the quayside has been stripped to its girders, as have most other buildings. A single ship sits at an odd angle in the harbour, with a tree growing out of its deck. Four swaggering youths in flip-flops accost your correspondent and demand to know what he is doing. They introduce themselves as three majors and a colonel from the Liberian security forces.

Practically nothing works in Liberia. There is no piped water, no functioning justice system and the closest approximation to a middle class is 60,000 civil servants who have hardly been paid in 14 years. There are 450,000 prosperous and well-educated Liberians, but they live in America and show no sign of returning. Liberia is not even ranked on the UNDP's annual “human development index”, for lack of data. “We're fighting to get to the bottom of the list,” says the UN's Mr Klein.

The only large organisation that functions adequately in Liberia is the UN. Besides keeping the peace, it helps refugees return home, inoculates babies, feeds a fifth of the population and trains local teachers, policemen, judges, army officers and so forth. This is helpful, but it is hard to support such a weak government without supplanting it. Because the UN offers the best salaries in

town, and actually pays them, it often ends up poaching the most able public servants.

The transitional government is better than its predecessor, in that it is less murderous. But it is not noticeably less corrupt. A senior UN official accuses it of making “no effort at all” to deliver social services.

The only large organisation that functions adequately in Liberia is the UN

The hope is that this will change after elections in October. There are dozens of possible candidates for the presidency, many of whom have no agenda beyond securing the top job, but there is at least a chance that someone honest will be elected. George Weah, a retired soccer star, is uniformly popular and far too rich to need to steal, but he has no political experience. The worst fear is that Charles Taylor or another warlord might sponsor a successful candidate and then pull the strings.

“Good governance has never crossed the doors of this country in 150 years,” admits Thomas Nimley, the foreign minister, “But now we are willing to learn.” Jerome Verdier, a human-rights lawyer in Monrovia, is less sanguine. “If the next government is as corrupt as the current one,” he says, “we'll have another war.”

If the UN were suddenly to pull out, Liberia would collapse again. But it won't pull out suddenly or soon. Sierra Leone, Liberia's neighbour, which collapsed just as bloodily in the late 1990s, offers a heartening example. Three years ago, it was in roughly the same situation as Liberia is today, held together only by 17,000 blue helmets. The peacekeepers have pulled out gradually, as the Sierra Leonean army has grown stronger with British training. After the last peacekeepers leave, Sierra Leone's elected government will still be shielded by a British promise to send back its troops if rebels attack it. The country is still poor and ill-governed, but it is no longer a charnel house, so it has a chance.

An important reason for optimism is that with the UN's help, Sierra Leone is holding to account those most responsible for despoiling it. A UN-backed special court indicted the 13 worst alleged war criminals. Two or three have since died, but David Crane, the chief prosecutor, argues that putting the others on trial strikes a blow against the culture of impunity that plagues Africa. Sierra Leoneans will see justice done on men who used to be untouchable. That could be the first step towards establishing the rule of law in a country that has never known it.

One indictee flagrantly evades arrest: Charles Taylor, whom the court is applying to have extradited from Nigeria. The Nigerians are not keen, having given him their word. But Mr Crane argues that Mr Taylor has violated the terms of his sanctuary agreement by continuing to meddle in Liberian politics, and predicts that he will soon be handed over.

Ultimately, fixing failed states is a job for the people who live in them. Outsiders can topple despots or crush rebels, and sometimes should. They can also offer cash and advice to help locals rebuild shattered institutions. But unless the fashion for colonialism returns, which it probably won't, they will not accept responsibility for governing the world's worst trouble spots. There will be no rest any time soon for the peacekeepers.

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Correction: Gaza's economy

Mar 3rd 2005
From The Economist print edition

Our table (see article) last week comparing the World Bank's with Israel's positions on Gaza's economy should have noted that some of the initiatives were Israel's, not the Bank's. Also, Israel has no objections to the West Bank-Gaza rail link and no abolition date for the quasi-customs union, and compensation is at issue for businesses, not houses or infrastructure.

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The European Union's finances

The battle of the budget

Mar 3rd 2005
From The Economist print edition

A quarrel over the EU budget could become the sleeper issue in referendums on the EU constitution—especially Britain's

MONEY is so often at the root of family squabbles. The European Union is no exception. Ever since Margaret Thatcher wielded her handbag in the 1980s to demand her money back, the budget has caused friction. The then Mrs Thatcher won a rebate for Britain at the Fontainebleau summit in 1984. But summits at Edinburgh in 1992 and Berlin in 1999 saw more budget rows. Now it may happen again, as EU leaders wrestle with the “financial perspective for 2007-13”.

The phrase sounds deceptively technical. What it means is fixing spending on the common agricultural policy (CAP), regional aid and so on for the next seven years. It must be done unanimously by all 25 members, which is hard because the budget is a zero-sum game: more for one country means less for others. The timing makes things harder. The Luxembourg presidency of the EU hopes to do a deal in June, but few believe it will. The presidency then passes to Britain, which will be fighting to protect its rebate and preparing for a referendum next year. On past precedent, the budget row could spill into 2006.

Next week, Britain's House of Lords EU select committee publishes a report* that sets out the main sticking-points. There are essentially four: how big the budget should be, how much should go to the CAP, how to distribute regional aid and the British budget rebate.

The EU budget is out of date. A 2003 report to the European Commission by a group of experts

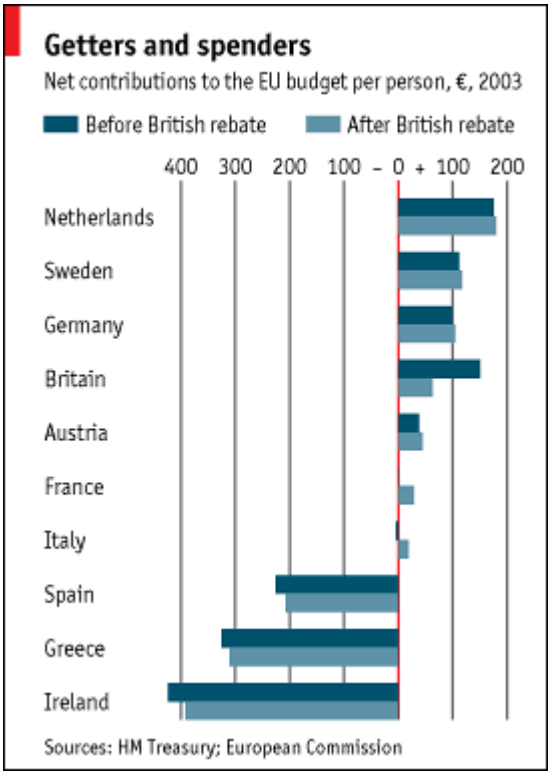
led by André Sapir, a Belgian economist, called it an “historical relic”. The Sapir report suggested a rethink, including scrapping CAP spending and shifting regional aid to new members. Sadly the commission, under pressure from national governments, ignored it. Instead, it proposed just to add a dollop to existing spending plans, lifting the budget from 1% of GDP (some €115 billion, or $150 billion, a year) to 1.14% by 2013.

The six biggest net contributors—Germany, Britain, France, the Netherlands, Sweden and Austria—want to keep the budget below 1%. Their views matter, since they account for three-quarters of net payments into the budget. Even so, they may have to compromise. Commission officials are already touting a middle ground around 1.07% of EU GDP.

One problem is that the six do not agree about what to cut. They disagree most about the CAP. In October 2002, France's president, Jacques Chirac, persuaded the German chancellor, Gerhard Schröder, to agree to keep CAP spending unchanged up to 2013. An EU summit pusillanimously endorsed this deal, so the commission had to stick to it in its financial perspective. Over 40% of the EU budget goes on the CAP, in support of a shrinking industry that accounts for less than 4% of EU GDP.

Yet it may be possible to reopen the Chirac-Schröder deal. As the Lords report notes, it sets ceilings, not targets, for spending. In the Doha round of trade talks, the EU has offered to scrap export subsidies for farm products. And, because past reforms of the CAP switch spending from production-linked subsidies to direct payments to farmers, the case for financing these nationally, not at EU level, is growing. If France's government wants its farmers to have higher incomes than Greece's, why not pay for them itself?

The obstacle to either cutting or renationalising the CAP is Mr Chirac himself. He cut his political teeth fighting for French farmers. In Berlin in 1999, he reopened a CAP reform earlier accepted by his own ministers, and also blocked national financing. Having stitched things up in advance this time, he will balk at more talk of reform, even if Doha demands it.



Arguments on the third issue, regional aid, could be just as heated. Britain is leading a camp demanding a switch of regional aid to the new members from central Europe, plus Greece and Portugal, the only old members with below-average GDP per head. There is something ludicrous in the commission's plan to spend over half of EU regional aid in the 15 older members, 13 of which have above-average incomes. But the commission knows that the big beneficiaries, such as Spain, will fight hard for their money. Spain was especially truculent in 1992, thereby securing floods of cash.

All this may, however, pale into insignificance compared with the likely row over Britain's budget rebate, which will pitch 24 countries against one. The commission has suggested replacing the rebate with a “generalised corrective mechanism” that would also produce rebates for Germany, the Netherlands and Sweden. Nobody seems to want this, least of all the British, since it would double their net contribution. The British insist they will veto any changes to the rebate, which they say remains justified because of the continuing distortion of the CAP. As the Lords report notes, a corollary is that, were big reform of the CAP on offer, the case for the British rebate would disappear—but France, the noisiest critic of the rebate, is also the loudest opponent of CAP reform.

Even so, Britain's case for keeping the rebate in its present form is weaker than it was. For one thing, its GDP per head has grown relatively fast. In 1984 Britain was the third-poorest member. Now it is richer than Germany, the Netherlands and Sweden, all three of which pay more per head into the budget. The rebate will also rise as the costs of EU enlargement kick in: from around €4 billion a year now to €7 billion by 2013. Britain, the fourth-biggest net contributor per head now (post-rebate), will be ninth-biggest on average between 2007 and 2013; for the first time, it will pay less than France and Italy. And it will not pay its whack for enlargement (indeed, new members will pay for its rebate).

Yet whatever the economic arguments, the political reality is that no British government could give up any of the Thatcher rebate, least of all when it has to win a tricky referendum. One official says flatly: “no rebate, no constitution”. The problem is the timing. The other 24 may be pushing hardest against the British rebate early next year, just as the referendum campaign is in full swing. One option then might be to stall negotiations on the budget until after the British vote. That might make budget planning for 2007 chaotic in the extreme—but still be preferable to the chaos that could follow a British no vote.

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* “Future Financing of the European Union”. Our Europe editor, John Peet, acted as an adviser to the House of Lords committee.

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France's finance minister

Breton to the rescue

Mar 3rd 2005 | PARIS
From The Economist print edition

A turnaround king is brought in to cure the ills of France's economy

THIERRY BRETON could not refuse twice. Jacques Chirac, France's president, tried to persuade the boss of France Telecom to be his finance minister last November, but he wanted to stay at the telecoms firm. Three months on, Mr Chirac was again looking for a finance minister. Now Mr Breton has agreed to become France's fourth in less than a year.

Mr Chirac needed to repair quickly the damage done by the resignation of Hervé Gaymard, Mr Breton's predecessor. Mr Gaymard got into trouble when *Le Canard Enchaîné*, a satirical newspaper, revealed that he and his large family had moved into a palatial flat in a posh part of Paris, at taxpayers' expense. After days of embarrassing revelations, made worse by contradictory statements from Mr Gaymard, Mr Chirac told his former protégé to go. By picking Mr Breton, he has both brought in somebody with private-sector skills and avoided a cabinet reshuffle.

Mr Breton, nicknamed *le zorro du business*, has helped to rescue three state-owned companies. He is credited with turning around Bull, a computer maker, and Thomson, a consumer-electronics firm, though critics say both floundered after he left. His biggest turnaround was France Telecom, which had over €70 billion ($69 billion) of debts when Mr Breton took over in 2002. After radical restructuring, France Telecom has pulled back from the brink of bankruptcy: its credit rating has risen from junk to investment grade, its net debt is down to €44 billion and it made net profits of €2.8 billion in 2004.

The new finance minister will need all his business savvy to manage France's state coffers. Growth remains anaemic at best. New figures this week put the budget deficit for 2004 at 3.7% of GDP; the government has pledged to cut it to below 3% next year. This will make it hard to cut income taxes, another government promise. Privatisations could help, but the unions are already up in arms against plans to sell parts of Electricité de France, Gaz de France and Areva, a maker of nuclear reactors.

Can Mr Breton turn France round? Privatisation is the kind of job he should be good at. He managed France Telecom's partial privatisation without stirring up huge labour unrest. He may also have more room for manoeuvre than some predecessors. Mr Chirac will surely try to keep the same finance minister until the end of his mandate in 2007. Mr Breton's German and British counterparts, Hans Eichel and Gordon Brown, have been in their jobs six and eight years, respectively.

If French business hopes for less state interference by Mr Breton, it may be disappointed. He believes the state should promote national champions. He may be less of a populist meddler than was Nicolas Sarkozy, who intervened in a merger in the drug industry last year and staged a big bail-out for Alstom, an engineering group. Yet when Mr Breton met the German economy minister, Wolfgang Clement, this week, he called for more “industrial co-operation” between the two

countries.

Mr Chirac is hoping the swift replacement of Mr Gaymard will limit any broader political damage. Some observers detected the hand of the ambitious Mr Sarkozy, Mr Chirac's great rival and boss of the ruling UMP political party, in the Gaymard revelations. The bigger worry is that the affair could affect the referendum on the European Union's constitution, likely to be held in May. A majority of voters support the treaty, but growing discontent with the government could change minds.

And grounds for discontent abound. Unemployment has hit 10%, a five-year high. On March 1st students protested against reforms of the educational system. Next week public-sector workers will take to the street to defend jobs and perks. The unions are mobilising to defend the 35-hour week. It adds up to quite a challenge for France's turnaround king.

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Germany's Green Party

Endangered species

Mar 3rd 2005 | BERLIN
From The Economist print edition

A party that suddenly seems less invulnerable than before

Get article background

MIGHT Germany's Greens need a spot of recycling? Newspaper readers may wonder. Whether lowbrow tabloid or highbrow weekly, much of the press now treats the Greens as self-righteous and incapable of accepting that well-intentioned policies can have ugly effects: eg, that opening up borders can be an invitation to people-trafficking. If Joschka Fischer, the party's posterboy and foreign minister, has to resign over a visa scandal provoked by this truth, the Greens could face a big electoral setback.

Salad days for Greens (Cohn-Bendit, left, Fischer, right)

This is a reversal of fortunes for the world's strongest environmental party. A few weeks ago, as it marked its 25th anniversary, the Green Party's world seemed in good shape. A year of success had made it the biggest party in some German cities. Mr Fischer was showered with compliments over his response to the Asian tsunami: he led the taskforce that worked round the clock to organise help.

If the Greens have come down to earth, one reason is that the opposition has changed strategy. Having realised that its leaders and programme are not attractive enough, the conservatives have resorted to aggressive attacks against the government. The scandal over visas issued to people-traffickers in Ukraine, now the subject of a parliamentary inquiry, provides ammunition: it weakens Mr Fischer, and seems to show that the entire government is soft on immigration despite Germany's terrible unemployment (which hit a post-war record of 5.2m in February).

Perhaps more important, the media seem ready to change their tune after years of shamelessly hyping the Greens and helping Mr Fischer to reach almost godlike status. Some of the generation of journalists now reaching positions of influence see themselves as actors with a political agenda, rather than mere reporters. *Der Spiegel*, the leading newsweekly, seems especially intent on pushing Mr Fischer out of office, after being a firm supporter in recent years.

If the attacks have hit home, it is partly because the Greens have let them. While success was springing eternal, they became complacent. It took weeks for them to realise how damaging the visa scandal could be, because it seems to show them up as moralists disconnected from reality. The reaction also highlights a contradiction the party has yet to resolve: the leadership is now decidedly pragmatic, but most party members see themselves as the only defenders of truth and goodness.

Germany's *Zeitgeist* also seems to be shifting away from things the Greens hold dear. Multiculturalism is increasingly under question. The public mood favours tighter security, as the visa scandal has shown. Germany's continuing economic malaise also makes people think twice about the merits of government regulation. Pending anti-discrimination laws are now seen as more costly red tape rather than harbingers of greater equality.

The Greens will not disappear even if Mr Fischer goes. That might cost the party a third of its votes, but it still has plenty of political assets. Green politicians are very professional, and can come up with new ideas. Many of their voters will stick with them no matter what. The crisis could even strengthen the party if it draws the right conclusions: that success is not automatic, and that it needs soon to groom a successor to the struggling god at the top.

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The Czech Republic and Slovakia

Gross misdemeanours

Mar 3rd 2005 | BRATISLAVA AND PRAGUE
From The Economist print edition

A tale of two countries, one doing badly, the other well

Get article background

WHEN Czechoslovakia broke up in 1993, the fate of its successor states seemed obvious. Slovakia would drift deeper into authoritarianism under its ham-fisted leader, Vladimir Meciar. The Czech Republic would be a model of prudence. For the next few years that was just what happened. But in the late 1990s the Czechs lost the secret of good government—and the Slovaks found it.

A fragile coalition ousted Mr Meciar in 1998, promising to get Slovakia into the European Union and NATO. It duly joined both last year. Its flat-tax reform has brought investors flocking in (see article). Voters re-elected the coalition in 2002 and may give it a third term next year, making Mikulas Dzurinda central Europe's longest-serving prime minister. Last week he proudly hosted the Bush-Putin summit in Bratislava.

In the Czech Republic, the idealism of the early 1990s has collapsed into cronyism and cynicism, thanks to selfish politicians and a complacent public. These days the government scarcely functions. A weak coalition, the second in this parliamentary term, was again on the verge of collapse this week. It is not serious politics that has provoked the crisis, but a scandal of almost incomprehensible silliness involving wives, uncles, trivial sums of money and burnt IOUs. An optimist might say that things can only get better. But with an unreconstructed Communist party getting stronger, things might yet get worse.

The trouble began when a Czech newspaper found in January that the prime minister, Stanislav Gross, a Social Democrat, had bought a flat in 1999 costing more than he could afford from his parliamentary salary. Mr Gross retorted that he had borrowed money from an uncle, who claimed to have borrowed it from relatives abroad but apparently got it from a Czech journalist, who took an IOU that he gave to a fringe politician, who burnt it—or so the parties claim. Later, a company belonging to Mr Gross's wife was reported to have bought a house with help from a woman later charged with fraud.

This week Mr Gross was arguing with one coalition partner, the Christian Democrats, which wants him to go, as do most voters. The Czech constitution makes snap elections hard, so the outcome could be yet another coalition, of Social Democrats, Christian Democrats and the Freedom Union—enough for a one-seat majority in the 200-seat parliament. Mr Gross's predecessor, Vladimir Spidla, struggled with a similar coalition last year, before becoming a European commissioner.

Mr Gross has no obvious successor in his party, so he could ride out the crisis. But that may mean looking for support from the Communists, who have 41 seats. Open co-operation would be a big step. All parties have shunned the Communists since the velvet revolution of 1989. If Mr Gross handled the adventure brilliantly, emasculating the Communists, the country might thank him. But

he is in a position of weakness, and might thus have to do much of the compromising. Many voters might then abandon his party in disgust.

Nothing in politics is immutable. If the weakness of the Social Democrats drives more Czechs to the right, that would raise the chances of a stronger government, led by the opposition Civic Democrats, at the next election. As for Slovakia, the most popular party in the country is the left-wing Smer (Direction), which wants to reverse Mr Dzurinda's reforms. Smer's leader, Robert Fico, who recently turned 40, can afford to wait: one day Mr Dzurinda will go. Perhaps the Czechs should bid for him.

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Russia's opposition

Pear-shaped

Mar 3rd 2005 | MOSCOW
From The Economist print edition

Russia's Victor Yushchenko? Not quite

"EVERYTHING is possible," said Mikhail Kasyanov when, after criticising Russia's government a year after being sacked as prime minister by President Vladimir Putin, he was asked if he might run for the presidency in 2008. Compared with Mikhail Fradkov, his compliant and over-promoted successor, Mr Kasyanov is now remembered as an independent reformer, whose defenestration marked the final ascendancy in the Kremlin of the *siloviki*, or "power people". Analogies have been drawn with Victor Yushchenko, once prime minister of Ukraine and now its president. Misplaced though these may be, the stir does point up two questions about Russia's liberal opposition.

Neither is whether Mr Kasyanov will be the next president. Everything may be possible in Russia, and Mr Putin's popularity has fallen slightly. Yet something huge would be needed to thwart his chosen successor in 2008 (Sergei Ivanov, the defence minister, is the current favourite) or, should he amend the constitution and stand for a third term, Mr Putin himself.

The first question is whether Russia's bickering liberal factions can unite and then spearhead a broad Ukraine-style opposition, with a view to the parliamentary poll in 2007, and perhaps the presidential elections in 2012 or 2016. A union between Yabloko and the Union of Right Forces (SPS), the two main liberal parties, has been mooted since 2003, when both fell short of the threshold for party-list representation in the Duma, or lower house of parliament. The merger's fruit, it is suggested, could be the "Pear" party.

Unfortunately, personal enmity obstructs such a deal, as do ideological divisions. Grigory Yavlinsky, Yabloko's leader, says SPS is "neo-conservative", while his party is liberal-democratic. Mr Yavlinsky adds that Mr Kasyanov is linked to the "criminal privatisations" of the 1990s, as well as the already repressive policies of the first Putin term. On this view, Mr Kasyanov and some SPS leaders are part of a bigger problem: that, for many Russians, democracy and capitalism have become synonymous with chaos and corruption.

By contrast, Boris Nemtsov, an SPS leader who now advises Mr Yushchenko, thinks Mr Kasyanov could indeed emerge as leader of a broad democratic opposition. But SPS is divided over how friendly it should be to Mr Putin. More wrangles over a merger might end in an SPS split, not a deal with Yabloko.

The second, more depressing question is whether, even if the liberals united, anybody would notice. The emergence of a Russian middle class ought by now to be boosting the standing of parties sticking up for business-friendly policies, the sanctity of private property, and the independence of the media and the judiciary. But, some gloomy liberals conclude, in Russia economic empowerment has not brought with it such political expectations.

Even winning seats in the Duma, says Mr Yavlinsky, would count for little, such is the Kremlin's

stranglehold. Given its grip on television, it would be hard for a new liberal leader to drum up support. Two candidates are Garry Kasparov, a chess champion turned anti-Putin campaigner, and Vladimir Ryzhkov, a courageously outspoken Duma deputy, but neither would find it easy to make a mark. As for Mikhail Khodorkovsky, ex-boss of the Yukos oil firm, who sponsored a range of political parties and was touted as a presidential contender, his trial is now reaching a less than suspenseful climax. It would be surprising if he were at liberty in 2008.

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Italian phone-tapping

Pronto

Mar 3rd 2005 | ROME
From The Economist print edition

The tangled tale of a country with too many phone taps

ITALIANS are strikingly un-private. They argue in public, pour out romantic secrets on television and talk so loudly and incessantly on their mobile telephones that it can be hard not to listen in. But even they worry that, when it comes to mobile-phone tapping, the authorities may have gone too far.

The biggest mobile-phone operator, Telecom Italia Mobile (TIM), has told the government it cannot meet demand by police and prosecutors for phone taps. All of the 5,000 duplicate lines it has for eavesdropping are in use. TIM is one of four mobile-phone operators, and there is a fixed-line operator, Telecom Italia. So extrapolating from TIM's subscribers, it seems that some 15,000 Italians are being bugged at any one time.

Roberto Castelli, the justice minister, accepted that there has been an “explosion” in the number of warrants for phone taps. It is doubling every two years and is “far higher than for any other European country”. Last year, phonetapping cost the Italian taxpayer €300m ($225m). Warrants are usually issued by a judge at the request of a prosecutor. Most are valid for a couple of weeks, or 40 days for organised-crime investigations. But they can be renewed.

A spokesman for the prosecutors argues that the spread of eavesdropping is justified because it is hard to persuade Italian witnesses to testify in court. The penalties for failing to appear can be less intimidating than the disincentives from organised-crime syndicates. Yet critics say investigators have become addicted to the evidence that phone tapping can supply; they worry that not enough attention is being paid to civil liberties.

A few days after TIM's letter, renewed controversy arose when extracts from intercepted conversations were broadcast on television. They were taken from evidence in a case that is still being tried. Three of the callers quoted were members of parliament. The programme showed that, before the 2001 G8 summit in Genoa, which led to violent clashes between police and demonstrators, Italian investigators had recorded conversations between left-wing lawmakers and anti-globalisation protesters, some of whom are now on trial on subversion charges. The outraged defendants declared that “no one is free from being bugged, from mayors to bishops, and from lawyers to clients.”

Meanwhile mobsters are taking more direct evasive action. A man shot dead outside a bar in Rome last month was found to have been the proud owner of no fewer than 22 mobile telephones.

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Charlemagne

Flat is beautiful

Mar 3rd 2005
From The Economist print edition

The impact of central Europe's tax revolution

ONE of the more bizarre events on the Brussels calendar is the annual capitalist ball, staged by the Centre for the New Europe, a free-market think-tank with an appropriately Rumsfeld-like title. This year's event was dedicated to the memory of Ayn Rand, a libertarian novelist and one-time muse to America's Federal Reserve chairman, Alan Greenspan. Her dedication to capitalism was so complete that, at her memorial service, a six-foot high dollar sign was placed next to the open coffin. Previous balls featured a cigar-chomping American speaker in a tuxedo, pumping the air and encouraging shouts of “Viva capitalism”.

The ball-goers are not what you might call mainstream Brussels. Officials from the European Commission are conspicuous by their absence. The core audience is drawn from a network of right-wing think-tanks in Europe and America. It would be easy to dismiss the whole thing as a fringe event. Who could be less relevant to the business of the European Union than a bunch of American conservatives and their wild-eyed fellow travellers from central Europe or Sweden?

But the free-marketeers may now have the last laugh. One of their most cherished policy ideas—the flat tax—is fast gaining ground in Europe. To its proponents, the flat tax is the ultimate in fiscal simplification. If all corporate and personal income is taxed at a single flat rate, that slashes red tape and improves incentives. But flat-tax opponents have always countered that it is unjust not to have higher marginal rates for the rich. When Steve Forbes proposed a flat tax in the American presidential primaries in 1998, it was widely dismissed as no more than an eccentric millionaire's fantasy.

An idea that failed to gain purchase in the United States is, however, fast winning converts right across central Europe. At the 2003 capitalist ball Mart Laar, a former prime minister of Estonia, was given a special award to celebrate the fact that, in 1994, his country had become the first in Europe to introduce a flat tax, of 26%. At the time, developments in Estonia, a tiny Baltic country which was not then even a member of the EU, did not seem particularly significant. True, Latvia and Lithuania, the two other Baltic countries, swiftly followed suit, but nothing much happened for a while after that.

Then in 2001 Russia, facing widespread tax evasion, moved to a flat tax of 13% on personal income. Over the next two years Serbia and Ukraine followed, with rates of 14% and 13%, respectively. Much as advocates of the privatisation of pensions were sometimes embarrassed to have Pinochet's Chile as their laboratory, so Russia, Serbia and pre-Yushchenko Ukraine were not the ideal poster children for flat taxes. But then Georgia, fresh from a democratic revolution, introduced the lowest flat tax yet: 12%. And the flat-tax experiment that has attracted most attention in the EU has been in Slovakia, where a 19% rate for all personal, corporate and sales taxes was introduced in 2003.

Slovakia's flat tax became a lot more significant when the country joined the EU a year later, thereby gaining complete and unfettered access to Europe's single market. As advocates of the flat tax had long predicted, Slovakia's fiscal innovation helped to spur foreign investment and economic growth, while actually leading to a slight increase in tax revenues. Encouraged by Slovakia's experience, Romania, which is supposed to join the EU in 2007, has just introduced a flat tax of 16%. The centre-right opposition parties in Poland and the Czech Republic are both now pushing the idea of flat taxes set at 15%.

To many in the rich, high-tax countries of western Europe, all of this smacks of the dreaded “race to the bottom”, long forecast by those who feared that the enlargement of the EU would lead to a loss of jobs and an erosion of the welfare state. Joschka Fischer, the German foreign minister, has argued that it is intolerable for his country, struggling with a rising budget deficit and unemployment of over 10%, to finance EU subsidies to countries that are luring investment and jobs out of Germany by slashing taxes. As Mr Fischer sees it, the Slovaks and others can afford to set low flat taxes only thanks to big EU subsidies. Reality is more complex. That tax revenues have actually risen in Slovakia makes it a lot harder to sustain the charge of “fiscal dumping”. The main cost advantage that central Europe has over Germany and France is not low taxes, but low wages: an average Slovak worker is paid about a fifth as much as his German counterpart.

If you can't beat 'em

Flat-taxers are in such an exuberant mood that they risk feeding the myth of fiscal dumping. At a recent Brussels seminar organised by the Stockholm Network of pro-market think-tanks, Dan Mitchell of America's Heritage Foundation crowed that France and Germany are “being caught in a pincer movement” by their flat-tax neighbours. “The money is going to leave those countries, investment will be leaving those countries, and sooner or later they will have to reform.” Mr Mitchell predicts that the flat-tax movement in Europe will be imitated around the world, rather like the Thatcher-Reagan cuts in income-tax rates and Ireland's cuts in corporate tax.

So far, the preferred response of the Germans and French is to press for an EU-wide ban on “fiscal dumping” and to push the EU towards tax harmonisation. The trouble is that EU decisions on tax are taken by unanimity—and there is no way that the Slovaks and others are going to surrender their freedom to set their own taxes. So some in western Europe are beginning to think of copying the flat-taxers, rather than fulminating against them. Gerrit Zalm, the Dutch finance minister, has said that his Liberal Party is considering a flat tax for the Netherlands, albeit at the high rate of over 30%. More surprisingly, advisers to left-of-centre governments in Spain and Germany have also done serious feasibility studies on flat taxes. If old Europe cannot beat the flat-taxers of new Europe, it may have to join them.

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Correction: George Lillikas

Mar 3rd 2005
From The Economist print edition

Last week (see article) we described George Lillikas as Cyprus's finance minister. He is in fact the minister for commerce, industry and tourism.

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The BBC

With one bound, Auntie was free

Mar 3rd 2005
From The Economist print edition

As usual, the BBC has got what it wants—for now

Get article background

NOT LONG ago, the BBC looked as if it was in deep trouble. Its chairman and director-general had both resigned in the aftermath of an inaccurate report about the Iraq war by one of its journalists. At the same time, the communications regulator was raising questions about the future of the licence fee—a flat tax on all households with televisions—that finances it. But once again, the BBC has triumphed over its enemies. This week the culture secretary, Tessa Jowell, secured its future with another ten years of generous public funding. The government also announced a reformed system of governance for the BBC, but a far less strict one than some advisers had proposed.

Ms Jowell was particularly struck by how popular the BBC still is. That is one reason why the 83-year-old corporation tends to get what it wants from politicians. Another is that, through its network of influential ex-employees, the BBC has considerable sway over policy. A third is that it is just too powerful for any but a foolhardy government to take on.

The BBC feared that Ms Jowell would replace the corporation's governors, who are supposed to hold it to account, with an external regulator with power to withhold money, as Lord Burns, a government adviser, argued she should in a report last December. Critics of the governors blamed them for failing to look after the public interest when Greg Dyke, the former director-general, and his chairman, Gavyn Davies, defended faulty reporting about Iraq's non-existent weapons of mass destruction. But Michael Grade, the BBC's new chairman, reportedly threatened to resign if Lord Burns got his way, arguing that a government-appointed external regulator would threaten the BBC's independence. He proposed a milder reform, which would essentially have allowed the BBC to go on governing itself.

Losing two chairmen in two years would have been embarrassing for the government. Its compromise is a new “BBC Trust”, separate from management, combined with a formal executive-management board. The new system will be tougher than Mr Grade's proposal, says the government, because members of the trust will have a legal obligation to represent the views of licence-fee payers to the management board.

But the more important victory for the BBC is that it has managed to hang on to the licence fee for another ten years even though its share of audience is falling as multi-channel TV becomes more popular. Now the licence fee will continue until at least 2016, well beyond 2012, when the government hopes to switch everyone over from analogue TV to the digital sort.

This decision may end up looking short-sighted in retrospect. Some digital set-top boxes can tell whether or not someone has paid to watch a particular channel. Conditional access will thus open the way for people to choose not to receive or pay for the BBC's channels—and for the BBC to

become a subscription service.

To protect its funding, the BBC made sure that the set-top boxes for its digital platform, Freeview, would not include conditional-access technology. As Mr Dyke explained in his memoirs, “the more Freeview boxes out there, the harder it will be to switch the BBC to a subscription service since most of the boxes can't be adapted for pay-TV”. But more and more people are buying a new generation of Freeview boxes with conditional access, points out David Chance, chairman of Top Up TV, a pay-TV service. By the time of digital switchover, most households will possess the technology to subscribe to the BBC if they want to, or not.

But that will not necessarily undermine the licence fee. Multi-channel households, the government found, are just as willing to pay for the BBC on top of their subscriptions to BSkyB or to Top Up TV. Even once subscription becomes an option, there may be little pressure for the government to abandon the licence fee.

A more fundamental problem for the licence fee, however, is that people are increasingly consuming BBC content on computers and mobile phones. Charging a flat fee for owning a computer is hardly an option: people who use theirs primarily to do their accounts or play games are unlikely to be happy about having a licence fee slapped on their hardware. When you can no longer tell what television is, how do you tax it?

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Anglican Communion

Breaking up gently

Mar 3rd 2005 | DROMANTINE, NORTHERN IRELAND
From The Economist print edition

If the Anglican Communion split up, could anybody tell?

Get article background

Reuters

Clinging to the past

EVEN by the standards of Irish stately homes, Dromantine is a splendid pile, set in many acres of rolling green parkland. If its mighty stone walls could speak, they would have much to say about inter-Christian squabbles. In the days of the original, Scottish Protestant, owners, a Roman priest would rarely have darkened their doors, although most locals are Catholic. This all changed after the first world war: the house was bought by the Catholic Church and became a place which few Protestants cared to enter.

Everything is much easier now, of course. The house's Catholic managers, many of them ex-missionaries from Africa, are bursting with enthusiasm for ecumenical encounters. So they were delighted when more than 30 prelates of the Anglican Communion, the spiritual leaders of 77m Christians from all over the world, spent a week with them. As their purple-robed guests stretched points and tried to bridge the almost unbridgeable, the smiles on the faces of their black-suited hosts seemed to widen.

In the circumstances, the proceedings at the primates' meeting were remarkably polite, as one would expect of a fairly loose association of self-governing Christian churches with common origins in the cerebral, cool-headed Church of England. But politeness and common cultural origins will not be enough to hold together a religious federation which has been in crisis since 2003 when the American branch ordained an openly gay bishop, Gene Robinson, and an Anglican diocese in Canada approved a rite of blessing for same-sex couples. Both these moves infuriated the conservatives, who are strongest in Africa and the developing world.

What the primates in Dromantine decided was to ask, very politely, if the North American liberals would stay away from regular participation in the Anglican Consultative Council, one of the so-called “instruments of unity” that holds the Communion together. This voluntary absence would last, it was gently suggested, until 2008, when the next of the Communion's ten-yearly policy-setting meetings is due to take place.

This request for North America to stay away was the minimum that the conservative lobby, known as the Global South, could have accepted. But the Dromantine statement also included words to assuage the free-thinking North Americans, accepting they had followed their own internal rules correctly.

Behind this careful language is the hard reality that even if the primates had resolved to restore unity at any cost, they could not easily have done so. As Canadian Anglicans have pointed out, their archbishop cannot simply tell a diocese to stop blessing gay unions; dioceses too have their own democratic procedures. And that in turn raises the question: is it all worth the effort?

In theory, the Anglican Communion is supposed to be a group of interdependent but autonomous churches. That only works if they all think and believe more or less the same things. Anglicanism has neither the vertical structure of the Roman Catholic Church, where the Vatican can whip dissenters into line, or the doctrinal unity of the Orthodox Church, where rival Patriarchs can be at war with one another (sometimes literally) but accept each other's spiritual authority. Instead, Anglicanism has inherited a very British set of instincts, one that aims to blur doctrinal differences and hopes that its component parts can somehow rub along like a fractious but ultimately affectionate family.

But modern families do in the end break up, as their members grow up and go their separate ways. That's just what seems to be happening to the Anglican Communion. As Edith Humphrey, a Canadian-born theologian, has argued, “the Anglican Church is fragmenting already, people are peeling off in different directions, whether to the Roman Catholics, the Orthodox or the nonconformists.”

If, as now seems possible, the liberal leaders of the American and Canadian churches decide to walk alone, conservative movements within those countries will probably insist that they, at least, want to remain part of the Anglican majority. That will put the Communion's leader, Rowan Williams, the Archbishop of Canterbury, in a tight spot. Personally liberal, but determined to maintain Anglican unity if at all possible, he will have to consider how far he should go in fostering internal splits within various national churches. If he encourages the North American traditionalists and eschews the liberals, he will find himself doing exactly that. Making such choices is especially difficult in a church which puts so much emphasis on softening hard edges.

Indeed, so soft have those edges become that the outsiders are entitled to ask: what difference would it actually make to Anglicans in the pews, or indeed anybody else, if the Communion were to break up? Not a great deal, probably.

One practical benefit of the Anglican association is that, in theory at least, each constituent church automatically accepts all the others' office-holders and rites whatever they may think of them. An Anglican bishop in Canada is acknowledged as one in India or Jamaica, whereas (although he is too polite to say so) the Pope doesn't see Archbishop Williams as anything more than an interesting professor.

Could it get to the point where an American couple (even one consisting of a man and a woman) who had been wed by Bishop Robinson would be considered fornicators if they went to, say, Malawi, on the grounds that the person who married them was not a real bishop? In theory it could, but in practice common sense tends to prevail. It is doubtless already true that Bishop Robinson would not be a very welcome preacher in Lagos or Nairobi.

A further practical benefit of Communion, some would say, is that Anglicans can speak with one voice on global issues like war and poverty. No Communion, no joint statements; though of course church leaders who agree will still get together to make their shared feelings felt.

Archbishop Williams has urged his fellow prelates to make sacrifices for the sake of unity. But he knows that, on both sides of the divide, there are people who see principles at stake—principles not worth sacrificing for the sake of good manners. He must hope, then, that those Catholic Irish eyes were smiling with sympathy rather than *Schadenfreude*.

Divorce

Breaking up is hard to do

Mar 3rd 2005
From The Economist print edition

Particularly if you're affluent and well educated

UNLIKE marriage, divorce shows no sign of going out of style. More than 150,000 English and Welsh couples cut the knot in 2003—the most for seven years. For every 100 weddings that year, there were 57 divorces. But marital breakdown is not just more statistically common. It is also becoming less socially exclusive.

In fiction and gossip columns, divorce afflicts rich, ambitious people whose aversion to long-term commitment is matched only by their greed. In reality, it is increasingly the preserve of the poor. New research by Tak Wing Chan, of Oxford University, and Brendan Halpin, of the University of Limerick, shows that working-class social patterns raise the risk of divorce: youthful marriage is disastrous; so is having three or more children (which, before the 1980s, proved a reliable way of holding a marriage together). Go to university, on the other hand, and your chance of breaking up falls sharply. Other things being equal, a woman with a degree who married in the late 1960s was 32% more likely than average to divorce within ten years. Educated women who married in the late 1980s were 27% less likely to do so.

That trend is evident to those who work with middle-class couples. Carol Martin-Sperry, a London marriage counsellor, reports that her clients have become more cautious about breaking up in recent years. They are increasingly willing to tolerate adultery—a common cause of splits. “Thirty years ago, infidelity was a much bigger deal,” she says.

The sticking power of well-to-do couples puzzles some sociologists and economists, whose theories predict the opposite outcome. According to the “independence hypothesis”, couples will remain married if their joint utility from marriage exceeds the sum of their utility when separated. Traditional unions divide paid work (male) from unpaid work (female), enabling greater productivity. But such a trade-off ought to appeal less to educated women, who can earn more on their own.

Mr Chan suggests two reasons why qualifications and commitment now go together. First, modern universities facilitate romance as reliably as they guarantee future earnings. In 1970, the universities contained 416,000 men but only 205,000 women, who may have been not just rare but exceptionally driven. As student numbers expanded, the balance equalised. That allows better matching. Second, women's earnings have become essential to the average middle-class household. They are simply more valuable.

Religious values may play a part, too. Churchgoing has collapsed across the country, but the decline has been much less pronounced in affluent areas, according to Christian Research, an independent think-tank. Divorce has also become cheaper, at least for those who have few assets to squabble over. About half of all people who go through it receive legal aid.

Affluent men may have been spooked into better behaviour by changes in the law. A House of Lords decision in 2000 established the principle of equal division of marital property. That has had a remarkable effect on the clients of Peter Martin, the head of family law at Osmond Gaunt & Rose, a London firm. “I have noticed that the wealthier husbands are thinking a lot more seriously about the consequences of having affairs,” he says.

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Ballet and politics

Tutu elitist

Mar 3rd 2005
From The Economist print edition

Class war in Richmond Park

WHITE LODGE, the Royal Ballet's junior school, sits in the middle of Richmond Park, an unspoilt chunk of wilderness in south-west London which was once a royal hunting ground. Children prepare for the big stage there from the age of 11, kept company by the deer (the Queen's ministers still get a haunch of venison after the annual cull). The school has applied for planning permission to improve its crumbling facilities. English Heritage, the Royal Parks agency and Richmond council all approved. But Ken Livingstone, London's mayor rejected it. The reason? The “remote location of the White Lodge site acts against the promotion of inclusiveness”.

Been bothering the badgers?

Yet White Lodge is a boarding school, so its elegant location does not make it inaccessible to anyone. Tony Arbour, the leader of the Conservative group on Richmond council, thinks that the mayor is punishing the Royal Ballet for not attracting enough poor and ethnic minority students. “We believe that he's abusing his planning powers to hasten his own political agenda,” says Mr Arbour.

Other elite arts institutions have had similar experiences. The Royal College of Music has lost around £100,000 a year because it does not attract enough poor students—which is hardly surprising, since the only 18-year-olds good enough to get in have been taking expensive music lessons since they were old enough to climb on to a piano stool. The Courtauld Institute, a postgraduate history of art college, has a similar problem.

The government's habit of censuring arts institutions for selecting only the best has conspired with a second factor—London's odd political set-up—against the ballet school. Though Mr Livingstone has a high profile in the city—partly thanks to his talent for offending people—his powers are limited. He has some authority over transport, which he used to bring in the congestion charge, and he can block planning applications.

This leaves Mr Livingstone trying to shape the city by using his blocking powers as a policy tool. The city has a mayor-approved London Plan, which is full of strategic aims that all applications must comply with. So schemes like the Royal Ballet's can be turned down not because they are ugly or impractical, but because they might not promote a prescribed set of social goods. And, for good measure, Mr Livingstone says that the application's benefits do not outweigh “the potential impact on existing badger setts”.

Mr Livingstone may yet back down and allow the Royal Ballet to improve its facilities. Happily, the

mayor's planning officers now say they have found a way to maintain badger “connectivity”, allowing the troublesome plantigrades to scuttle freely between the grounds of White Lodge and the park. And the school is not as stuffy as he thinks; it has an expensive outreach programme. One result of this is that White Lodge now has many more boys applying for places. The Royal Ballet says this is also partly thanks to “Billy Elliot”, a movie about a poor but astonishingly talented boy who becomes a ballet star. Perhaps the school should now put on a ballet about a poor but astonishingly talented boy who becomes a mayor.

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Women and work

Having it all

Mar 3rd 2005
From The Economist print edition

How Labour's family-friendly plans work against equal pay

A MAJORITY of women voters have backed the Conservatives in every general election bar one since the franchise was extended in 1928. The exception came in 1997, when New Labour managed to undo the structural advantage that had made the Tories the most successful political party of the 20th century.

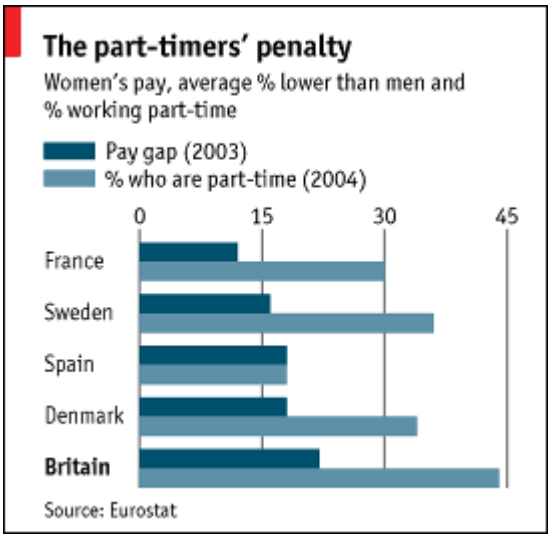
Hanging on to those women is central to Tony Blair's strategy for the election expected in May. That helps explain why, after the Tories made gains in polls last week, the government responded by announcing initiatives on flexible work, and Mr Blair spent 15 minutes publicising them on Radio 4's “Woman's Hour”, talking a lot about his close relationship with his children along the way.

Labour launched similar schemes before the last election. Among other things, they gave parents of children under six the right to ask employers for a more flexible schedule. Officials say nearly a million people have done so since the Employment Act came into force in April 2003. Bosses don't have to say yes to every request, but they must give a good business reason if they don't. The law also boosted maternity leave and gave new fathers the right to two weeks' paid leave.

Most of Mr Blair's schemes had already been announced in the pre-budget report last year. The government wants to extend maternity pay (which comes out of the government's pocket, not employers') from six months to nine, and eventually to a year. It will also consider expanding the right of workers to ask for flexible work to parents of children older than six, and to those caring for the sick.

Businesses are windy about the changes. The British Chambers of Commerce says that while its members have had little trouble with the flexible work request law so far, 62% were against extending it. The strongest opposition comes from small businesses, which already feel over-regulated. “Individually these regulations are not too onerous”, says David Frost, the group's director. They become burdensome, he says, “when you stack them all together”.

But the proposals could also work against another of the government's stated aims: to narrow the pay gap. Men working full-time still earn 18% more per hour than full-time women, down from 30% in 1970. One likely reason for the stubborn pay gap is that by taking career breaks to look after children, women often move out of the fast track and into the slow lane. “If you're trying to fit somebody who works flexibly into a culture of long hours, they may get marginalised,” says Sarah Churchman of PricewaterhouseCoopers. The high proportion of British women who work part-time may help explain why the British pay gap is also large (see chart).



One proposed solution to the problem—forcing companies to publish audits of the salaries they pay men and women—is unlikely to change that. Mr Blair hopes that the Women and Work Commission, which produces an interim report on March 8th, will find some answers. That might help convince working mothers that he is on their side. But making more part-time work go together with equal pay is beyond even Mr Blair's talents for triangulation.

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Girl Guides

Brown Owl needs you

Mar 3rd 2005
From The Economist print edition

I promise to do my best (if I can find the time)

Britain's trendiest ladies' club

THE Guides, whose origins lie among child auxiliaries in the Boer War, and who teach unfashionable virtues like loyalty, duty and public-spiritedness, do not sound like the kind of youth club that would hold much appeal for today's media-savvy children and their cynical parents. But they have not just survived in the modern world: they are flourishing. There are 600,000 of them, and a waiting list of 50,000. In some areas, parents register their daughters for membership at birth, a practice usually reserved for the grandest public schools.

Nicole-Louise Hambridge, of Girlguiding UK, says that the movement (which includes the Rainbows, Brownies, Guides and Senior Section) remains popular with children because it has kept up with the times. Guides still collect badges, but, alongside traditional activities like camping and cooking, girls can get them in things like computer skills, circus performing and “diversity”. The group's colonial-style uniforms have been replaced with new, trendier ones from Ally Capellino, a fashion designer, and much of the old imperial stuffiness is gone. “It's a lot less regimented than it used to be,” says Miss Hambridge, pointing out that while it used to be compulsory for Guides to promise to love God and serve queen and country, they can now choose not to if they wish.

It is the adults, not the children, who are deserting. Girlguiding UK reckons it needs another 8,000 leaders, (called Brown Owls by the Brownies) to give places to everybody who wants to join. It blames the pressures of modern life for the shortage. More people are bringing up children single-handedly, or are in families where both parents work. The proportion of women in the workforce has risen from 42.5% in 1971 to 53.4% in 2004. That makes it harder to find time for good deeds. Ironically, that same lack of free time is another reason why the Guides remain popular: frazzled parents like the idea of someone else taking care of their children one night a week.

But in other ways, the Guides and the modern economy are surprisingly compatible. Carol Hardy, an HR consultant who also leads the 8th Maidstone Brownies, points out that looking after a group of girls on a camping trip teaches just the sort of leadership and teamwork skills that employers say they like.

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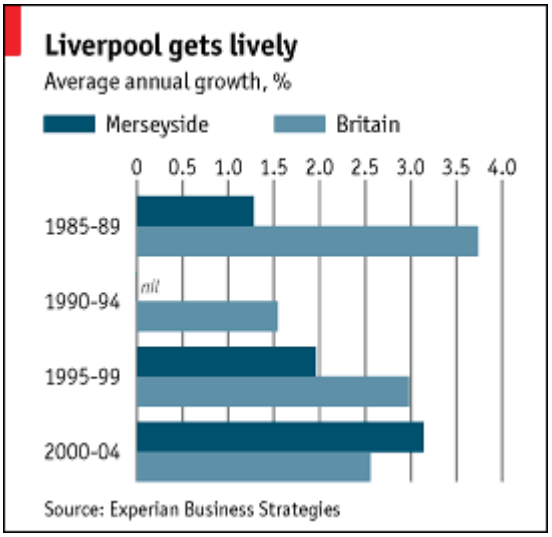
Merseyside

Beating faster

Mar 3rd 2005 | LIVERPOOL
From The Economist print edition

Subsidy and dependence on the public sector notwithstanding, things are looking up in Liverpool



DRIVE into Liverpool from Manchester, and the signs of economic dereliction which once dominated the landscape are gone. Close to a gleaming new airport terminal are Ford's Jaguar factory and some shiny new pharmaceutical plants. Further in, rows of modern suburban houses give way to smart converted warehouse apartments crowding round a city centre sprouting construction cranes.

For most of the last two decades of the previous century, growth on Merseyside was either stagnant or much slower than in the rest of Britain (see chart). Now the opposite is true. “Things had been so bad for so long that it is difficult to see how they could have got worse,” says Andrew Burrell, an economist with Experian Business Strategies, a consultancy. “But as other places have become more expensive, Liverpool has become a more popular place to develop and invest.”

Admittedly, subsidies have sharpened developers' enthusiasm. By 2008, 14 years after Merseyside was designated one of the EU's poorest regions, about £3 billion of EU and British government cash will have been poured in. Much of that has gone into developing smart city centre flats, one reason why Liverpool's population, which plunged from 791,000 in 1951 to 439,000 in 2001, has stopped falling. Though the city is still a net exporter of people, local planners point out that in 2003, the city's working age population grew by about 3,500. The unemployment claimant count, which soared above 20% in the 1980s, is down to 4.9% in Liverpool and 3.5% in Merseyside, above the British average of 2.2%, but not excessively so.

Some of the construction is still propped up by subsidy. A £400m waterfront indoor arena, conference centre, office, and flats development due to start soon is getting £133m of aid. But others are not. A much bigger £800m scheme by Grosvenor, a big property firm, now under way to rebuild 42.5 acres (17 hectares) of the city centre with 30 new buildings including three department stores will get no subsidy at all, says Rodney Holmes, Grosvenor's retail projects director.

In the 1980s, he says, when Militant, a Trotskyist faction within the Labour Party, ruled city hall and even the 1990s, when memories of this period were sharp, such an investment would have been unthinkable. But in 1998, the Liberal Democrats ousted Labour. “The council has now got a very charismatic leader and a very effective chief executive,” he says.

Others share his enthusiasm. In 2004, Merseyside lured 20 inward investment projects valued at £45.5m, nearly four times more than in 1999. Winning these prizes is more straightforward than five years ago, and a lot easier than 15 years ago, says Tom O'Brien, chief executive of the Mersey Partnership, which promotes public-private ventures. The tax breaks offered in an enterprise zone set up in 1981 at Speke, beside the airport, attracted just £20m of investment in ten years. Since 1996, about £330m has been lured in.

This new confidence extends to office building. Bruntwood, a northern property firm, is spending £37m refurbishing the former Littlewoods headquarters. More will follow if developers win tussles with city planners to build two skyscrapers—one of 51 storeys, the other 40 storeys—on the banks of the Mersey. A big reason for the developers' confidence is cheapness; city centre rentals, averaging about £120 per square metre, are half the cost of similar offices in Manchester, but low land prices still allow a profit. Patrick Gormley, project director for CSC, a computer services firm which set up an office with 380 people in Knowsley a year ago, says that low rents and availability of labour were more important than subsidy in persuading his company to choose Merseyside.

Low labour and housing costs help too. Unisys, a big information services firm, took over administration of Royal & Sun Alliance's life insurance and pensions in Liverpool two years ago. Starting salaries for their 1,000 employees are just £12,000 a year, says Nigel Raywood, a manager, but a good many are able to live within walking distance of the city centre office.

Yet the public sector still dominates Liverpool's office market. With 38% of Liverpudlians (compared with 25% of Britons) working for the state, it occupies about 35% of available space and accounts for half of recent employment growth in the city. It also leads the market: the Department for Constitutional Affairs is due to move staff later this year into offices that cost £180 per square metre, the highest rent recorded in the city.

The public sector's dominance raises some long-term economic questions. But at least Liverpool is competing with other cities as a place to develop. A decade ago, it wasn't even in the game.

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Bagehot

Out of order

Mar 3rd 2005
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Charles Clarke, the home secretary, has had a difficult week. Tony Blair is to blame

THEY marched their troops to the top of the hill, flags flying, drums beating to defeat the government's deeply flawed anti-terror bill. But with a famous victory in sight, Tory generals promptly marched them down again.

Tony Blair has rejected the Tories' suggested compromise—adding a “sunset clause” to the bill, which would mean the legislation would self-combust in eight months' time. But despite the huffing and puffing on both sides, there is huge pressure to do a deal. A compromise that gives the government a range of “control orders” and allows it to put suspected terrorists under house arrest remains likely when the House of Lords sends this highly contentious bill back to the House of Commons next week.

For all their recent trumpeting of civil liberties, the Tories now fear being on the “wrong” side of the argument. The media's fury at the bill and the government's disarray in the House of Commons on March 1st, when its majority fell to 14 votes, counted less in the Tories' calculations than a YouGov opinion poll in that morning's *Daily Telegraph*. Twice as many Tory supporters (64% to 32%) favoured restricting the civil liberties of suspected terrorists, even when there wasn't enough evidence to convict them, as opposed the policy. As a senior Tory put it: “This is the worst example imaginable of legislation in haste, but if there was some Madrid-style terrorist outrage during the election, it could reflect very badly on us.”

That, of course, is precisely what ministers fear too. Although there may be electoral advantage in appearing tougher on terrorism than their opposition counterparts, neither the home secretary, Charles Clarke, nor Tony Blair can have enjoyed the kind of criticism, much of it from their own side, they have been on the receiving end of this week. Civil liberties may be a minority sport in Britain, but it's a minority that includes most Labour activists (if not voters). Nor does it look good for a government with a working majority of 165 to come so close to defeat when a general election is looming. The rebellion was especially uncomfortable because the scepticism of dissident Labour MPs brought back unpleasant memories of other trust-related issues.

The determination of Mr Clarke and Mr Blair to press ahead with legislation that they know a lot of reasonable and intelligent people loathe reflects their certainty that if there is a big terrorist attack, many of the same people will not hesitate to blame them for not having done enough to prevent it. Modern British political culture castigates government for its over-bearing, interfering ways, yet holds it accountable whenever anything goes seriously wrong.

To that extent, ministers deserve some sympathy for having bowed to the fears of the security advisers who constantly bend their ears with prophecies of doom. But they don't for the way they have gone about changing the law since the end of last year when the Law Lords said that the government could no longer keep foreign terrorists in prison indefinitely without trial. With a brand

new home secretary, a Home Office already suffering from acute legislative drafting fatigue and an election around the corner, the dangers of Number 10 rushing to meet the deadline of March 14th (when the existing detention powers expire) should have been obvious.

After all, just eight months ago, Mr Blair received a withering dressing-down over his style of government from Lord Butler, a former cabinet secretary, who reported on the uses and misuses of intelligence before the war with Iraq. Lord Butler's central critique was that Mr Blair's government failed to understand the value of process in making judgments and reaching decisions, and that was why his government had failed to assess the threat from Iraq correctly.

Sir Michael Quinlan, a former permanent secretary, observed a few days after Lord Butler reported: “Mr Blair has sought to bring to his prime ministership a strong focus on delivery...This salutary concern can, however, slide into a sense that outcome is the only true reality and that process is flummery...Process is care and thoroughness; it is consultation, involvement and co-ownership.”

It is doubtful, for instance, whether there has been even the most cursory discussion within the government on the issue which caused so much trouble in the Commons—the important question of precisely when judges should be involved in orders restricting innocent people's liberties. The cabinet, without Mr Clarke in attendance, was given an “update” last week, but there was little in the way of debate. Mr Blair's impatience with process also contributed to the bad feeling in the Commons. Important concessions on the role of the judiciary were made too late for MPs to know exactly what they were voting for, and their political benefit was thus lost.

There he goes again

Mr Blair himself lent further weight to the impression that he has failed to learn Lord Butler's lessons when he told BBC Radio 4's “Woman's Hour”: “There are several hundred of them in this country who we believe are engaged in plotting or trying to commit terrorist acts.” According to security chiefs, Mr Blair should have said that there are several hundred people who are watched because they might at some time get up to mischief.

It's a pity that Mr Blair feels he must exaggerate to convince people the threat from terrorism is real and serious when only fools doubt it. It's worse that he persists in dealing with difficult issues in such a careless, slipshod and confrontational way. Most people understand that laws with the power to change fundamentally the relationship between the state and the individual should not be made by crude political horse-trading taking place against an arbitrary time limit during the run-up to an election. It is odd that the prime minister does not.

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The tiger in front

Mar 3rd 2005
From The Economist print edition

AFP

India can learn much from China's breakneck economic expansion. But it has valuable lessons for China, too, argues Simon Long (interviewed here)

Get article background

HOME to nearly two-fifths of humanity, two neighbouring countries, India and China, are two of the world's fastest-growing economies. The world is taking notice. In December, a report by America's National Intelligence Council likened their emergence in the early 21st century to the rise of Germany in the 19th and America in the 20th, with “impacts potentially as dramatic”.

Comparisons between the two are inevitable. Both are poor, largely agricultural, countries that have made great strides in reducing poverty, especially since embarking on radical, liberalising economic reform. But India and China, always very different civilisations, have followed very different paths to growth. Under reform, they have converged somewhat in the past two decades, but will remain distinctive.

Take the way the two countries reacted to the recent deaths of two reformist leaders. India's P.V. Narasimha Rao, who died in December, was prime minister of India in 1991, when his government rescued the country from financial crisis and launched India's economic reforms. He served until 1996, but was later convicted of corruption. Although he won an appeal, the taint never quite left his name. His death, however, was marked by a state funeral and seven days of official mourning. The media vigorously debated his legacy.

When Zhao Ziyang, a former Chinese prime minister and head of the Communist Party, died three

weeks later, he got just a couple of lines from the official news agency. He had been out of favour since siding with student protesters in Beijing's Tiananmen Square against hardliners in his own party in 1989. Dissidents were prevented from attending his funeral. It took two weeks to negotiate an official obituary. His successors, nervous that his memory might evoke the bloody suppression of the protests, did their best to erase it.

That India is an open society and China is not is one of the most glaring differences between the two. Some people in both countries are tempted to use it to explain another: that China's economy has grown much faster. This survey will argue that this view is simplistic and misleading.

Some of the main reasons for China's better performance have nothing to do with the political system. When China started its reforms, in 1978, it was poorer than India. Part of the gap now is due simply to that earlier start. But also, unreformed China seems to have done a more impressive job than India did in educating and providing health care for its poor. Reforms benefited from what economists call “good human capital”, and from a bulge in the working-age population that India itself is now experiencing.

In terms of integration into the global economy, the Chinese reforms have gone much further than India's have, and reaped bigger rewards. But India and China still face similar challenges. When George Fernandes, an Indian opposition politician who was defence minister in the previous government, visited China in 2003, he asked China's prime minister, Wen Jiabao, to list his economic priorities. The answers—unemployment, regional disparities and the enduring poverty of farmers—applied just as much to India. Mr Fernandes, once known as a critic of China, concluded: “We are both sailing in the same boat.”

The two countries have much else in common. Both have massive populations with correspondingly massive needs for resources, especially land, water and energy. Both need to find ways of stemming environmental decay. Both suffer under-reported HIV infection rates. Both face potentially destabilising external disputes: China with America over Taiwan, India with Pakistan over Kashmir.

Both, moreover, have each other: as model or as warning, and as so far largely unexploited economic opportunity. This survey will argue that there are lessons India can draw from China's experience, but that the “Chinese model” need not mean anything resembling its political authoritarianism. In that respect, India has much to teach China.

India is often portrayed as an elephant: big, lumbering and slow off the mark. Now investment-bank reports are beginning to talk of it as a new Asian “tiger”. If that is what it wants to be, it makes sense for it to study China: the tiger in front is Chinese.

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The great divide

Mar 3rd 2005
From The Economist print edition

If this is a race, India has already been lapped

100% keen to learn

RETURNING to visit Beijing or Shanghai after a few years' gap is a bewildering experience. After negotiating slick new airports, new expressways whisk you into town. Occasionally, through the new skyscrapers, a familiar building appears, lost in the concrete jungle. Parts of China have seen perhaps history's biggest construction boom.

A return to Delhi or Mumbai, by contrast, is a reassuring if frustrating experience. The only great innovation in the airports (and don't knock it) is an improved queuing system in the crowded immigration halls. The roads into town are clogged at night with lorries bearing redundant injunctions to “horn please”. In the traffic jams, cripples and young mothers with babes in arms beg at car windows. There are new buildings and roads, and, in Delhi, a splendid new underground railway. But these cities are still themselves. Whereas its neighbour has been transformed out of all recognition, India has, in most visible essentials, stayed the same.

Measuring this difference is difficult. Indians object that Chinese statistics are fudged or concocted by local officials trying to impress their superiors. They do not add up. When the government said, “Speed up!”, the numbers exaggerated growth. Now that the government says, “Slow down!”, they understate it. Yet in broad terms, the trends they show and the story they tell—of China's outperforming India—make sense, and fit the evidence of the eyes. Statistical objections are just one symptom of an Indian state of denial.

Many Indians have little patience for foreigners who cannot see beyond the airports and the beggars to the many wonders of India—including its recently fast-growing economy. Some foreigners are equally intolerant, wondering why they should see beyond such inefficiency and poverty, and how their hosts have managed to do so for so long. The changes in China have given them another stick to beat India with.

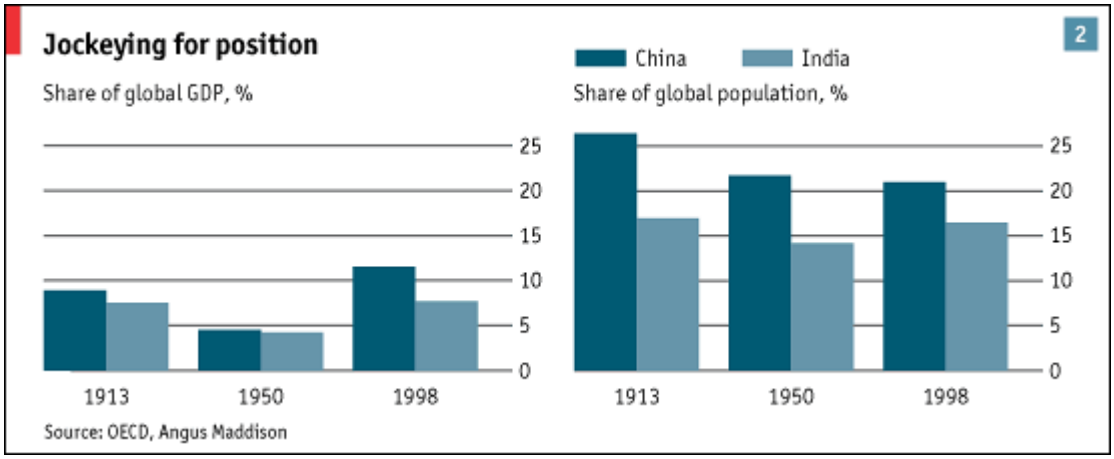
Yet there are beggars in China too, and the divergence in the data is a recent phenomenon. Measured by purchasing power per person, China's GDP did not overtake India's until the early 1990s. Since then, both economies have seen spurts of growth. India's real GDP grew by an average of 5.6% a year in the 1980s and by 5.8% a year from 1991 to 2003. China's acceleration was comparable, but from a much higher starting point—9.3% in the 1980s, rising to 9.7% between 1991 and 2003.

A giant and a half

Because India's population has been growing much faster, GDP per person has diverged even more. China's grew by an average of 8.5% between 1990 and 2003, India's by 4%. As a result, China's national income per head in 2003, measured in current dollars, was $1,100, compared with $530 in India: a staggering gap, given their recent parity. Adjusted for purchasing power, China has grown to be 70% richer than India.

According to Angus Maddison, an economic historian, who has studied the two countries from a "millennial perspective", two centuries ago China was slightly richer than India, but has been poorer for most of the time since then. In 1990 dollars, India's national income per head grew from $533 in 1820 to $673 in 1913, whereas China's declined from $600 to $552. By 1950, India's income per head was $619 and China's $439, although in absolute terms China's share of global GDP remained ahead. In every decade since then, China's growth in GDP per head has outpaced India's.

One consequence of this is that during the past century India's population and GDP have remained roughly constant as a percentage of the world totals (see chart 2). China's population, by contrast, has shrunk from a quarter to a fifth of the total. In the 20th century, it was ravaged by terrible natural disasters, as well as, in 1958-61, by the greatest man-made famine in history, which killed perhaps 30m people. Since 1980 its population growth has been constrained by strict birth-control policies. Meanwhile China's share of global GDP, adjusted for purchasing power, has risen from 8.9% in 1913 to over 11% in 2000 and 13% last year.



In terms of international trade, the difference between the two countries is even more dramatic. In 1990, China's share of world exports was 1.9% and of imports 1.6%. By 2003 its share of exports had increased to 5.8% and of imports to 5.3%. Last year, two-way trade grew by 36% and China overtook Japan to become the world's third-largest trader behind America and Germany. In the 1990s, China's trade-to-GDP ratio went up by over 70%. No other country came close to that. India's increase was 23%.

Indian trade has also been growing fast, notching up a 16% rise last year. Even so, its total two-way trade last year was only around $150 billion, less than 1% of the global total. For the third year running, the increase in China's trade was bigger than India's total foreign trade. This means the two countries have vastly different weights in the global trading system, but it has also changed mutual perceptions. Indian exporters, who two years ago feared that Chinese competition might be the end of them, now worry that a hard landing in China might destroy a big growth market.

China's foreign-exchange reserves are almost five times the size of India's, having increased by $207 billion in 2004 to reach $610 billion at the end of the year. As an engine of global growth,

China has become an important partner in the economic debate among the rich countries. On its own figures, last year it contributed 12% of the growth in global merchandise trade. The exchange rate of its currency, the yuan, pegged to the dollar at an artificially low level, has become a big issue in the world economy. Nobody seems to give two hoots about the rupee.

China's government as well as its people worry about rising inequality, but the rapid growth has brought a sharp drop in the share of the population living in poverty. According to the World Bank, the number of people living on less than $1 a day, measured at purchasing-power parity, fell by about 400m between 1981 and 2001. “We have a lot of confidence that poverty has been almost eradicated,” says David Dollar, who represents the World Bank in China.

For richer, for poorer

Not in India. According to Indian government figures, the number of poor in India fell by 69m between 1977 and 2000, but that left 260m still in poverty. The World Bank estimates that 35% of Indians live on less than $1 a day, compared with 17% of Chinese. According to the Food and Agriculture Organisation, the number of undernourished people in China fell from 194m in 1990-92 to 142m a decade later. In India the corresponding numbers are 221m and 216m, meaning it is still home to a quarter of the world's undernourished. Some 47% of India's under-five-year-olds are underweight, compared with 10% in China. Infant mortality is 65 per 1,000 in India against 30 in China; life expectancy at birth is 63 in India, 71 in China; and adult literacy is 57% against 91%.

In the Human Development Index devised by the United Nations Development Programme, China, with a score of 0.745 (out of a possible 1), comes 94th out of 177 countries. India, with 0.595,

comes 127th. Its officials take comfort from its rapid improvement—a 36% rise in its index score since 1980. As Amartya Sen, a Nobel-prize winning economist, points out, the life-expectancy gap in favour of China, which was 14 years in 1979, has been cut in half. Life expectancy in parts of China may now actually be falling, such is the collapse of basic health care.

What is remarkable, however, is that on these basic measures of living standards China should have started from a base so much higher than India's. When China launched its reforms at the end of 1978, it had only just emerged from the nightmare of the Cultural Revolution and, before that, the economic mass suicide of the Great Leap Forward. Yet when Mao Zedong died in 1976, he did at least bequeath his successors the human capital needed for growth.

Indeed, if, from a welter of dubious data, one were to pick out the most telling single statistic about the difference between India and China, it might well be female illiteracy rates. According to the World Bank, 87% of adult Chinese women are literate. The equivalent figure in India is 45%. Many things follow from educating girls: better health and education and longer lives for the whole family; more productive workers; and a boost to industrialisation and urbanisation. “An educated child”, says Asian Demographics' Mr Laurent, “does not want to plant rice.”

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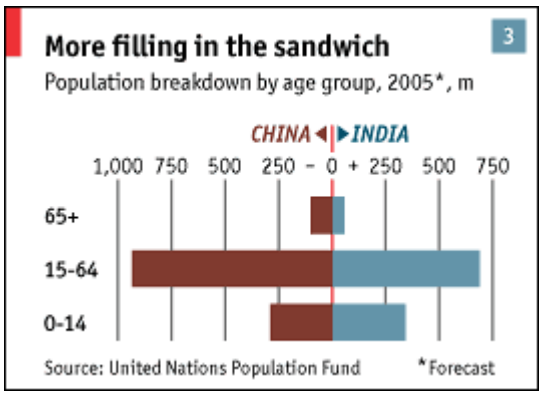
It's the people, stupid

Mar 3rd 2005
From The Economist print edition

Can India turn its growing population into a competitive advantage?



THE numbers, as ever, are disputed; but it seems beyond doubt that China is ageing faster than any other country in history. It is unique in growing old before it has grown rich. The “one-child” policy introduced in 1980 was soon relaxed to allow many people in the countryside to have two children if the first was a girl. The restrictions were also widely flouted by those who could afford a fine or a bribe to pay for extra children.

Even so, the policy has had a dramatic effect. China says 300m births over the past 30 years have been “averted”. That means 300m fewer mouths to feed, but also 300m fewer workers and 300m fewer offspring to lavish Confucian respect on their forebears. In the coming decades China will have to cope with caring for an ageing population. And in the mid-2020s, on official projections, the working-age population will start shrinking. “There will be more dependents and at the same time fewer workers to support them,” says Siri Tellier of the United Nations Population Fund in Beijing.

India, with an average age of 26, is a younger country than China (33), and has started to look on its growing population as a potential asset. A 2003 report by Goldman Sachs, an investment bank, on the four big emerging economies—Brazil, Russia, India and China—suggested that, alone among them, India's economy would continue to grow at more than 5% a year until 2050. Indians thought this was good news, despite two reasons for the conclusion: that it is the poorest of the four, so it has more to catch up on; and that its population will continue to grow until 2050, so its GDP per head will remain the lowest of the four, even by the middle of this century.

India, with an annual population growth of 1.6%, twice China's rate, is expected to overtake its neighbour as the world's most populous nation around 2035. In other Asian countries, the bulge in the working-age population that India is now experiencing brought rapid economic growth. For India to achieve the same, however, it needs to educate its children better. That task will become harder, and the competition for scarce land and water more intense, as their numbers increase.

China, in contrast, will have more resources to devote to teaching fewer children. On Chinese figures, the fertility rate has fallen to 1.8. This is often thought to be an underestimate, because of the widespread breaches of the family-planning policies, but many demographers reckon it is actually an overestimate, a smoothing upwards of a figure that would otherwise have shown too drastic a decline. Clint Laurent of Asian Demographics, a research firm, says his people have cross-checked the number of reported births with other data from censuses and primary schools, and concluded that there has been overcounting to the tune of several million. He expects the working-age population to peak in 2009, at around 924m, and to decline to 835m by 2024.

Yet many economists argue that China is likely to suffer from a labour surplus rather than a

shortage for years to come. Already some say the internet has become a way of keeping the idle young amused. Shanda, an online-gaming firm based in Shanghai, reckons that its games attract an average of 1.7m concurrent players, the majority of them young men aged 18-24.

The other consequence of smaller families has been a sex ratio strongly skewed in favour of boys. In China there are 118 boys for every 100 girls born, compared with a natural ratio of 105 to 100. India's figures are also skewed, but to a lesser extent. The most recent census, in 2001, showed 108 boys under the age of seven for every 100 girls. In some of the most prosperous states, however, the imbalance is much more marked: in Delhi, for instance, the ratio at birth in the first half of last year was 122 boys to 100 girls.

In both countries, the alarming numbers result from a confluence of tradition and modern technology. Sons carry the family name and land and provide an insurance policy for old age; daughters go off to look after somebody else's old age, and, in India, require a dowry. As more people can afford to pay for ultrasound scans and illegal selective abortions, they choose to avoid the longer-term expense of having girls.

Nobody knows what effect this preponderance of boys will have on Chinese and Indian society in the future. The trend might correct itself as scarcity forces up the value of girls. Yet in prosperous northern Indian states, far from commanding a bride-price, women whose families have failed to stump up a sufficient dowry still get killed and disfigured. It is the saddest of market failures.

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The insidious charms of foreign investment

Mar 3rd 2005
From The Economist print edition

China's cup overflows; India catches the spillage

You name it, we make it

IN 1976, during one of Deng Xiaoping's spells of political disgrace, he was the object of a national campaign of criticism. Among the most heinous of his alleged crimes was writing an essay in which he argued, in Marxist terminology, that it was possible to import foreign "means of production" without importing the "relations of production"—in other words, opening up the economy need not change China's political and social system.

His critics—the Maoists shortly to be vanquished as the "Gang of Four"—saw this as heresy. Looking around China now, they might feel ashamed but vindicated, despite the Communist Party's enduring grip on power. Foreign trade and investment have transformed the party and the country. Some of the changes—to the environment, in particular—are hideous. But it is hard to argue that life in China was better 30 years ago than it is now.

No other country attracts as much foreign direct investment (FDI) as China does. Last year some $60 billion poured in, about twelve times the amount that flowed into India. Between 1979 and 2004, China absorbed a total of about $560 billion in FDI. According to a survey of big firms by A.T. Kearney, a management consultancy, India is the next most popular destination for foreign investment in manufacturing after China. But in the past four years it has received almost $200 billion less in FDI than China has.

Rakesh Mohan, a respected economist who now works in India's Ministry of Finance, argues that this difference is overstated. Besides FDI, India attracts several billion dollars a year in portfolio investment ($9 billion last year). It also draws in billions of dollars in deposits from non-resident Indians ($33.3 billion outstanding last year), says Mr Mohan. Add all this up, and India is not so far behind China—especially if you allow for Chinese domestic investors "round-tripping", using foreign vehicles to take advantage of tax breaks.

It is not just a matter of money, however. Minority portfolio investors do not bring foreign technology and management systems, or competition that helps raise the efficiency of domestic firms. As for Indian banks, they are much healthier than their Chinese counterparts and hence better placed to intermediate between savers and investors. But they still keep some 40% of their assets in government bonds.

The foreign-investment boom in China was started by overseas Chinese. From 1985 to 1996, two-thirds of foreign investment in China came from Hong Kong, Macau and Taiwan. There China has, close at hand, some 30m ethnic Chinese, many of them with close ties to the mainland. Moreover, these places specialised in labour-intensive manufacturing industries for export. Wage costs were rising fast, so, in effect, they exported their trade surpluses with America to coastal China. They were made very welcome, for political as well as economic reasons, and paved the way for the big multinationals.

Overseas Indians, in contrast, are scattered around the world and across professions. There are a number of global tycoons, tens of thousands of software engineers who powered Silicon Valley's dotcom boom, and millions of others. It is not surprising they have played a different role to that of the Chinese diaspora.

Build it and they will come

China has two main attractions for foreign investors: a potentially vast domestic market; and an environment from which it is easy to export. The first of these has often proved chimerical in the past, and people with money for discretionary spending are still in a minority, though a far larger one than in India: 300m as against 50m, on one multinational's estimate.

Calculations by Asian Demographics showed that average urban household incomes in the two countries in 2002 were roughly similar. However, China has far more urban households. Because of the one-child policy, they are smaller—usually three people rather than five, as in India—and therefore have more money to spend. In 2002, some 70% of urban Chinese households earned between $2,000 and $7,500 a year. In India, a higher proportion earned more than $7,500 (6.4% compared with China's 1.2%), but 73.5% earned less than $2,000. China has a fairly broad-based middle class. India has a narrow affluent elite.

To take one example, consider the market for personal computers. India, despite its information-technology prowess, has one of the lowest penetration rates in the world. Forrester, a research outfit, expects this to increase by 37% a year until 2010, which means an extra 80m computers. But in the same period China will add 178m.

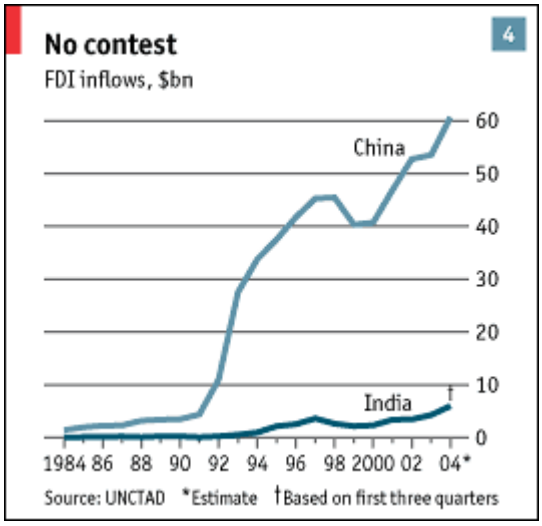
China's other big advantage over India is its infrastructure. It has 30,000km (19,000 miles) of expressway, ten times as much as India, and six times as many mobile and fixed-line telephones per 1,000 people. Although last summer saw serious power shortages in parts of China, India's supply is far more unreliable. In India, 61% of manufacturing firms own generators, compared with 27% in China, where the cost of power is 39% lower than in India.

There are pockets of excellence in India, such as the “campuses” built by the big software-development firms. But, by and large, they have had to do everything themselves, relying on their own power, communications

systems and even bus services. Leave the campus and you re-enter the third world.

Even Bangalore, epicentre of India's IT industry, suffers from traffic jams, overflowing hotels, power cuts and an inadequate airport. It risks throwing away its great advantage: that it has attracted a critical mass of the world's high-technology firms to what could be a self-sustaining cluster and boomtown.

In China, provinces compete to lure investment. Paran Balakrishnan, of India's *Telegraph* newspaper, once accompanied a party of Indian businessmen to China and explains that they were flabbergasted, on approaching the northern town of Datong, to find their bus joined by the local mayor and given a police escort. Few Indian state officials or politicians go out of their way to attract foreign investors.



Hangzhou, the capital of Zhejiang province, makes an interesting comparison with Bangalore. Both have populations of around 6.5m and a wealth of colleges. Bangalore enjoys the best climate in India, and Hangzhou has an idyllic lakeside setting, so both have obvious attractions for technology firms. But Hangzhou's new airport opened in 2000, whereas Bangalore's has languished for years on the drawing board. Hangzhou is linked to Shanghai by a fast 100km (62.5-mile) expressway. Its charm may have been buried under new concrete, but it is ready for business.

Softly, softly

Ah! say Indians, but what about the people, and the “soft infrastructure”, of laws, institutions and financial markets? Surely there India has a lead? Certainly, at the high end of the market, China cannot equal India's supply of technical wizards with fluent English. India's failures in elementary education should not obscure the excellence of some of its colleges.

Dan Scheinman of Cisco, the world's largest maker of networking equipment, says that Shanghai, too, has achieved a critical mass in the numbers of software engineers available. He finds it hard to differentiate between the two countries, either in the quality or the cost of their labour. In both, firms like Cisco are dealing with just a tiny fraction of the population, a group of exceptional people—though the churning of a workforce constantly on the lookout for a better job is a bigger problem in Bangalore than in Shanghai.

In labour-intensive manufacturing, however, Chinese workers, with their better elementary education, have a big advantage. World Bank research suggests that they are 25% more expensive than India's, but 50% more productive.

Corruption hampers business in both countries. In an index of perceptions produced by Transparency International, a monitoring group, India's score of 2.8 has remained constant for a decade. Anything below 3 indicates “rampant corruption”. Last year it ranked 90th out of 146 countries (with the 146th being the most corrupt). In 1995 perceptions of China were even lower: a mere 2.16. But it has since climbed to 3.4, and ranks 71st.

Even India's elaborate and well-developed legal system is not as much of an advantage over China as you might think. It is true that in some areas, such as the protection of intellectual property,

India is far ahead. But Raj Pande, a lawyer with the firm Paul Hastings, observes that China, starting “with a clean slate” and unburdened by outdated rules, has the chance to build better regulatory frameworks.

Only a few years ago, Chinese outfits preferred contracts you could write on the back of an envelope and wriggle out of at will. Now, however, says Andrew Halper, who has worked in Shanghai for Eversheds, a British law firm, “waves of foreign investment battering away”, not to mention competition between locations, have brought more investor-friendly contracts.

Private-property rights are still far behind those of the developed world. But, argues the World Bank's Mr Dollar, China's property rights have improved far faster than other countries', and they are better than those in many other developing countries.

Enforcement of rights and contracts, however, remains troublesome, with the judicial corruption you would expect in a one-party state. But India is not a model in this regard either. It has a judicial backlog of an astonishing 26m cases. The contracts may be watertight, but you can get soaked waiting for a judgment. As Mr Pande points out, this clearly has a damaging effect on compliance.

Foreign investment in some sectors of the Indian economy—such as insurance and the media—is limited to a minority stake. In others, such as retailing, it is banned altogether. Even when liberalisation arrives, as it did in civil aviation late last year, it sometimes comes with perverse conditions attached (in this instance, that foreign investors were welcome—unless they were foreign airlines).

China, too, has its limits, of course. But having entered the WTO on much tougher terms than did India, it is liberalising far faster. The remarkable thing, says Gordon Orr, of the Shanghai office of McKinsey, a consultancy, is how China has allowed foreigners to come in and dominate entire industries—carmaking, for example.

Jairam Ramesh, of India's ruling Congress party, blames the difference on the Indian bourgeoisie. China's capitalists were wiped out in the various purges of the 1950s and 1960s. India's middle class, however, nurtured under British colonialism and the “licence raj” of government-sponsored internal protectionism, is still a force to be reckoned with. So, too, unlike in China, are trade unions, although they probably represent less than 5% of India's 400m-strong labour force.

India's trade unions and employers sometimes unite against a common foreign enemy. In January, for example, both groups opposed the government's decision to lift, for future projects, a rule known as Press Note 18 that acted as a deterrent to investment by giving Indian firms a veto over their foreign joint-venture partners' other investments in India. In China, communism had beaten both capital and labour into submission, though Deng's reforms were opposed by party conservatives and state-owned industry.

Who wants it anyway?

Is all that foreign commercial influence in China an unqualified boon? For unadventurous foreigner and cosmopolitan Chinese alike, it may be a comfort that the country has 150 Starbucks coffee shops, but does it stunt native skinny-latte entrepreneurs, such as those behind India's Barista chain?

In a more sophisticated form, this was the question asked in an article in *Foreign Policy* in July 2003 by Tarun Khanna of Harvard Business School and Yasheng Huang of MIT. It caught Indian

eyes with its mouth-watering title, “Can India Overtake China?”, and its even juicier conclusion: that India's path “may well deliver more sustainable progress than China's FDI-driven approach”.

In a book about FDI in China published in the same year, “Selling China”, Mr Huang argues that the FDI China takes in shows up the huge deficiencies of its own corporate sector. “The cumulative result is that Chinese firms are less competitive than they would be otherwise.” When a Chinese company emerges into the limelight, it is usually for a blunder or for sheer clout. Lenovo, for example, a computer-maker, late last year agreed to buy the personal-computer business of America's IBM. This said much about Lenovo's ambitions, but also about its inadequacies.

India, for its part, has fostered genuine entrepreneurship in some industries by favouring domestic investment over foreign. It has produced IT firms such as Infosys, Wipro and Tata Consultancy Services that are among the world's best. Mr Khanna says that, since the *Foreign Policy* article appeared, he has revised his opinion of Indian companies downwards. Outside the IT industry, many retain the bad habits and feuding that often afflict family firms. The biggest private-sector firm of them all, Reliance, a textiles and mobile-telephony giant, is torn by a bitter public squabble between its bosses, the late founder's two sons. Mr Khanna's view of Chinese companies, however, remains that most are “anything but world class”.

This is a fascinating debate. But, to put it crudely, so what? It hardly impinges on the big issue: how does a poor country become less poor? China has produced no great companies, although it is now the world's third-largest spender on research and development. Yet, in just two decades, China's people have, on average, become twice as rich as India's. Andy Xie, an economist at the Hong Kong office of Morgan Stanley, an investment bank, points out that very few of the firms that built the American economy at the end of the 19th century are world-beaters today—and yet they laid the foundation for the country's sustained long-term growth.

It pays to be profligate

The “so what?” also applies to the argument that India is much more efficient than China at using capital. Having invested an average of 22-23% of GDP for a decade, it has seen average economic growth of about 6% a year in real terms. China has invested twice as much, but its average growth rate has been only about 50% higher than India's. It is indeed staggering how much investment is needed to power Chinese growth. This measure (the incremental capital output ratio) has been climbing in recent years, but the investment figures include land sales, which makes them unreliable.

All the same, China has undeniably enjoyed an investment boom, which is why pessimists expect its economy to come crashing to earth. Its growth of 9.1% in 2003 required investment of 42% of GDP, and last year's 9.5% probably needed an even higher ratio. Anywhere else, capital accumulation on that scale would look like a bubble. However, few economists in China and Hong Kong expect a hard landing, let alone a crash. First, they argue, there is no reason to expect investment suddenly to dry up. And second, there are signs that consumption is stronger than in recent years, and may withstand a falling-off in investment. For the first time in 20 years, consumption growth may be uncoupling itself from investment. Retail sales in December were up 14.5% on the same month in 2003.

India, meanwhile, is grappling with an even more fundamental difficulty: how to raise investment rates. To emulate China's growth, India would need to increase its investment to 30-35% of GDP, and there is little sign it can do that. Dominique Dwor-Frécaut, of Barclays Capital in Singapore, jokes that China's trouble is capital that costs zero. India's is zero capital.

Suman Bery, head of the National Council for Applied Economic Research in Delhi, says both

countries face the same challenge: a failure of financial intermediation. Neither has found efficient ways to translate high rates of private savings into productive investment. China's answer has been FDI, leading to what Mr Bery calls the “idiocy” of Chinese peasant savings financing the American Treasury. In India, the consequences have been underinvestment and a big fiscal deficit, financed by the banking system.

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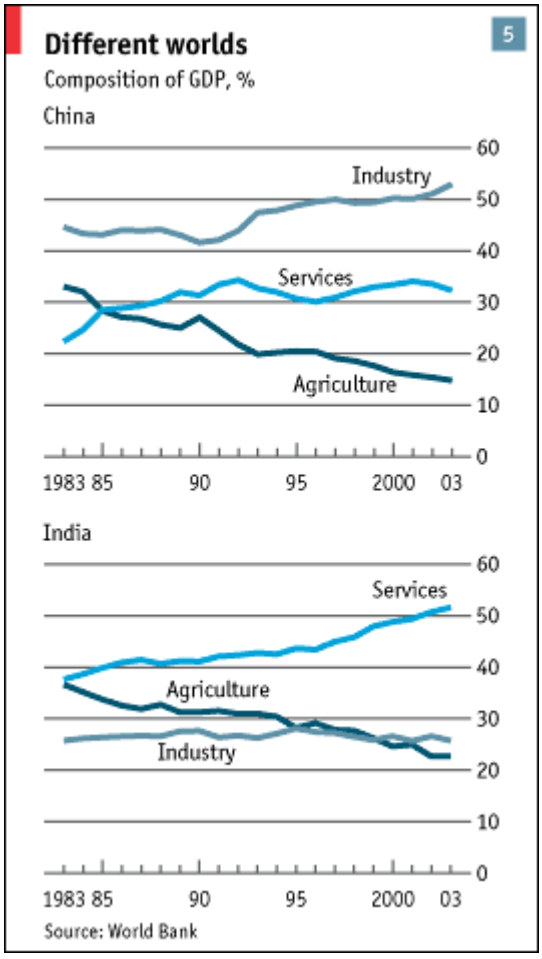
Sweatshops and technocoolies

Mar 3rd 2005
From The Economist print edition

India needs to emulate China's industrial revolution

THE justified pride that India takes in its IT prowess, and the outsourcing boom it has helped spawn, cannot disguise its irrelevance to the vast mass of Indians. The entire industry employs only about 1m people. According to estimates by NASSCOM, its lobby, income in 2004 from exports of software and services, and from outsourced services such as call-centres, reached nearly $17 billion, equivalent to a quarter of India's merchandise exports. But the industry makes up only 4% of India's GDP, and only a small fraction of the service sector as a whole.

So the notion that India can somehow skip a development phase and jump straight to a post-industrial, IT-services-led economy is not taken very seriously. That it has any currency at all stems from a trend that at first sight seems odd: as agriculture's share in the economy has shrunk, its place has been taken not by industry but by services (see chart 5).



The contrast with China is stark. There, as farmers leave the land they go into labour-intensive manufacturing. However, research by Jim Gordon and Poonam Gupta of the IMF has shown that, although services make up a somewhat bigger share of its economy than is usual for a country at its stage of development, India is far from being an oddity. Rather, it is China that is peculiar in having such a stunted services sector. This may be a relic of the old Stalinist model with its emphasis on heavy industrialisation in the countryside. Or it may simply be due to the under-reporting of China's informal sector.

For India, it is nevertheless worrying that industry has, until recently, grown so much more slowly than services, and has provided so few jobs. The government's numbers show that in 2002 just 6.2m people were employed in manufacturing, fewer than in 1991 (6.3m)—though this partly reflects a change in definitions.

In China, about 160m people work in “secondary industries”, ie, manufacturing. One reflection of the country's resounding success at becoming the world's workshop was the global panic at the lifting of quotas on its clothing exports at the end of last year. Some forecasters thought that China might snatch as much as half of the big quota-constrained markets, the EU and America. India, by contrast, was expected to grab at most 15%, even though the business plays to Indian strengths—cheap labour, a domestic supply of both cotton and man-made fibres, and a long textile tradition. Yet here, as in

so many other areas, India is following in China's wake, not overtaking it.

Under Manmohan Singh as prime minister, the Indian government has recognised where it needs to concentrate its resources if the country is to raise its long-term growth prospects from about 6% a year to 8% or more. In speech after speech he and his ministers emphasise the importance of improving the lot of farmers, of raising levels of investment, especially in infrastructure, and of delivering elementary education and primary health care. In January, Mr Singh even spoke of adopting “the Chinese model”. But does that really make any sense in such a different political and social environment? It does, up to a point. Consider four areas: agriculture, investment in industry, government finances and foreign trade.

Down off the farm

In China, reform started in the late 1970s with the explosive burst of energy that came from the dismantling of the old rural collectives and communes. The “responsibility” system, in effect returning land to individual farmers, boosted rural incomes and freed tens of millions to work in new “township and village” industries. India has no hope of such a one-off miracle. But if it is to raise growth rates closer to China's, it has to move people from the land into factories.

At present, roughly 70% of Indians live in the countryside, compared with 60% of Chinese (though some economists think the real figure is lower). Both countries face similar agricultural problems. After big surges in yields, productivity has stagnated, albeit at much higher levels in China than in India. In 2001, China produced 6,350 kilos of rice and 3,823 kilos of wheat per hectare, compared with 2,964 kilos of rice and 2,742 of wheat in India.

Both have distorting price and subsidy regimes that favour excessive grain production. In both, many farms are too small and farmers too poor to invest in inputs. There is little access to rural credit. Land has been degraded, water is scarce, and in many places groundwater has been extracted at unsustainable rates. There is mounting competition with cities and industry for land and resources.

Already, many farmers are idle much of the year. Large numbers are on the move from fertile places with a labour surplus, such as Sichuan in China and Bihar in India. In China the number of migrant workers is estimated at anywhere between 100m and 150m, despite a restrictive registration system (“hukou”). India, by contrast, has comparatively few: about 11m in 1999-2000, according to national surveys.

The absence of mass migration in India also reflects the poor levels of basic education and the lack of job opportunities. That is partly explained by the barriers to investment, which the government has pledged to lift. Some are already vanishing as the relics of the licence raj are dismantled. Every year, for example, more products are freed from the rules “reserving” their production for small businesses (though they still cover 600 items, such as hairbrushes and socks).

Firing workers remains hard in India, which deters firms from hiring them in the first place. This has a big impact on productivity. Many firms feel unable to reap economies of scale, because once they employ more than 100 people they become subject to the restrictive labour laws. In China, at first only in the four Special Economic Zones set up in 1980, but nationwide later that decade, companies were given the freedom to lay off staff and to link pay to performance.

Indian bureaucracy continues to slow things down. According to a World Bank “Investment Climate Assessment” published last November, it takes 89 days to secure all the permits needed to start a business in India, compared with 41 in China. Insolvency procedures take ten years, compared with 2.4 in China.

Access to land is a further obstacle. Ownership is often unclear, use and transfer are subject to many restrictions, and land transactions incur high stamp duties. All of this restricts the supply of land and pushes up prices. According to the World Bank, land prices relative to incomes are ten times higher in Delhi and Mumbai than in Tokyo.

Fixing that hole

For both domestic and foreign investors, India's poor infrastructure remains a huge barrier. Again, the government recognises this. But a combined state- and central-government deficit of about 10% of GDP for the past seven years leaves little leeway to build for growth.

China hardly seems a model in its handling of public finances. Although its consolidated fiscal deficit is modest, at 2.5% of GDP, the budget is opaque, and there is a vast disguised deficit in the form of the mountains of non-performing loans—as much as 40-50% of the total—that have piled up in the banking system. For years, the banks eased the pain of restructuring loss-making state-owned industries by continuing to throw money at them. They also financed a large part of that impressive infrastructure, built by bankrupt local governments.

The road to riches

However, China has shown India the way in one respect: tax reform. There is much waste in the Indian budget, notably in the form of ill-directed price subsidies. But most expenditure is hard to cut: mainly interest payments (about 44% of recurrent expenses), but also defence and civil-service wages and pensions. If India's government is going to make a difference, it needs to raise more taxes.

Central-government tax receipts have actually fallen as a percentage of GDP since the reforms of 1991, from 10% to around 9% now. In China, over the same period, they have risen from 15% to 19% of GDP—and GDP itself has grown from 124% the size of India's to 240%. China's government simply has far more money to spend than India's does.

India's tax system suffers from widespread evasion of direct taxes and a proliferation of confusing indirect ones. To counter the first problem, officials sometimes toy with the idea of replacing all the currency in circulation, to trap those who have profited from the many deals still transacted with suitcases full of used 100-rupee notes. Simplification of a system riddled with exemptions, discretion and arcane rules would also help.

As for the second, India is, from April 1st this year, to make its fourth attempt at introducing a national value-added tax (VAT). China's experience is encouraging. Before 1994, the country's tax

system suffered many of India's current woes: a confusion of cascading state and municipal sales taxes, state-border taxes, excise duties and levies. Now it has a single VAT, levied at 17% on most manufactured goods in all provinces. This provides a steady one-third of the government's tax revenues. Import tariffs have fallen from 10% of government tax revenues in 1985 to about 5% now, and direct corporation and income taxes from about one-third to 15%.

Properly implemented, India's VAT could have a similar impact. Eventually it would also speed up freight, as lorries would no longer have to stop at state borders. Because a company pays tax only on the value it has added, claiming back the tax it has already paid on inputs, VAT should also, in theory, be less easily evaded, and in time increase government revenues.

That should also help the government cut customs duties, which at present account for about one-sixth of its tax revenues. India's average import-tariff rate, at 20%, is about double China's. Cutting it would do much to spur competition and improve industry's productivity. In some industries Indian manufacturers have already shown that they can compete with the best in the world. Once the government's inhibiting protection has gone, there is no reason why they should not do so in others.

Reforms that would, in time, improve manufacturing competitiveness should also help reduce the fiscal deficit. That, in turn, would help lower the cost of capital, and allow more government spending on the big needs: infrastructure, education and health. In Deng's era, there was a popular phrase in China: “To get rich, first build a road.” And, one might add, use it to take girls to school.

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Two concepts of liberty?

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Democracy and growth are not in competition

AP

Party piece

PUT ten Chinese in a room, goes an old joke, and you would be hard pressed to get them to speak. Put ten Indians together, and you would never get them to shut up. It is a gross generalisation, but anybody who has worked in both countries would recognise a grain of truth, in political as well as cultural terms.

China is incomparably more relaxed than it was a generation ago. People are still not free to bring about political change, but they are, by and large, free to ignore politics. Yet it is still a one-party dictatorship where the one party has remained in power only because, in 1989, the army shot people to keep it there. Tens of thousands of people are locked up merely for exercising their rights to freedom of expression, association or belief. Torture and ill-treatment remain widespread. All of this is bound to breed a certain diffidence.

In India, on the other hand, every shade of opinion is noisily expressed. Pratap Bhanu Mehta, of Jawaharlal Nehru University in Delhi, in a book called “The Burden of Democracy”, quotes Clement Attlee, a former British prime minister: “Democracy means government by discussion, but it is only effective if you can stop people talking.” India, it sometimes seems, will never reach that point.

Arun Shourie, an Indian journalist, economist and former privatisation minister, expressed a similar exasperation in 2003 when the proposed sale of government shares in two oil companies was blocked by a Supreme Court ruling: “This is the difference between India and China. In India everybody has a veto.”

This is an excuse often given for the maddeningly slow pace of reform in India, its stop-go cycles and its constant back-pedalling. In China, goes the argument, the government or party no sooner

issues an order than it is done. A mind-boggling scheme to dam the Yangzi river and generate electricity at the Three Gorges, involving the forcible resettlement of 1.3m people, the destruction of priceless cultural relics and the risk of silting, flooding and the nightmare of an earthquake? No problem. By contrast, in India, the argument continues, such pharaonic ambition would not stand a chance.

There are three obvious objections to this. First, China is not a monolith, and decision-making there can also be painfully slow (for example, the Three Gorges project was first mooted in the 1920s). Second, that this could never happen in India might be a good thing. And third, India has had its own controversial grandiose projects, including dams. But most Indians seem to accept that a more indecisive, less radical government is the price of democracy. As Jia Qingguo, a professor of international studies at Beijing University, puts it: “Democracy in essence is a conservative arrangement. If all interests are represented, how can you make rapid and fundamental reforms?”

The compensation for Indians is stability. Except for the brief interlude of “emergency” imposed in 1975 by Indira Gandhi, the then prime minister, Indian democracy has stuck. It may have seemed an improbable experiment in such a poor, ethnically divided and hierarchical society, but it has proved resilient and deep-rooted. Turnout at elections is higher than in many developed countries—and it is the poor who vote in large numbers. The system may not deliver economic growth rates of 9-10%, but nor has it imposed Mao Zedong's murderous millenarian lunacies.

India's stability should not be taken for granted, and it is relative. It has encompassed several insurgencies, in Punjab, Kashmir and the north-east, and a long-running Maoist rebellion that has affected a quarter of India's 593 districts. On several occasions, most recently three years ago in Gujarat, parts of the country have been scarred by vicious communal violence. The war in Kashmir, whose flames are fanned from Pakistan but whose fuel is disaffection with Delhi, has taken perhaps 60,000 lives, and seen Indian forces engage in persistent human-rights abuses. Yet none of this has posed a systemic threat to India's democratic structure.

In China, by contrast, the big question is how a party that presided over such catastrophic blunders and crimes, in particular the famine of 1958-61, has managed to remain in office. Only recently has it offered anything resembling stability. Indeed, the 15 years since the Beijing massacre of 1989 are not only the longest period of relative political calm since “liberation” in 1949; they probably represent the longest such period China has enjoyed since the Opium Wars of 1840. Professor Jia argues that the present stability dates back to the Deng Xiaoping restoration of 1978. The protests in 1989 were, in retrospect, “a minor interruption”. That is indeed how it now seems, though by the party's own account at the time, “serious turmoil” afflicted dozens of China's cities.

On this view of India, it has chosen stability of a sort over growth. In the words of Meghnad Desai, an Indian-born economist, “to stay a peaceful and stable society, India has to be a muddle and a mess.” India has more than a billion people, 29 states enjoying considerable autonomy, 33 main languages and 1,650 dialects, and six main religions, one of which—Islam—is followed by 13% of the population. A slow-moving but flexible democracy is the only way of holding all this together.

The corresponding analysis of China is that there the party has done the choosing. It has opted for growth over freedom, imposing stability by force. The people accept this because the party has delivered on its side of the bargain, and because it has generated nationalist enthusiasm for regaining China's place in the world, overturning a century of humiliation at the hands of foreigners.

Like India, China is as big and diverse as a continent, though it is ethnically far more homogeneous, with more than 90% belonging to the Han majority, and has spent far more of its

history as a united nation. But, argue the doomsayers, because China has no institutional framework for managing dissent, and because its ossified political structures cannot cope with the economic transformation of the country, it risks a huge explosion: “The Coming Collapse of China”, as one book title succinctly puts it.

Blame the player, not the instrument

These caricatures of the two countries do democracy an injustice. It is not to blame for India's relative poverty. After Jawaharlal Nehru became independent India's first prime minister in 1947, his Congress party enjoyed three decades of uninterrupted rule, most of them with a large parliamentary majority. It took the chance on offer to make radical choices and changes. It is not democracy's fault that many of them were the wrong ones.

AFP

The slow business of democracy

But that is not to deny that India needs political reform. Again, the present government talks much sense on the issue. But the very reasons the system needs an overhaul may make it impossible to implement. There are three main needs: for better politicians; for less fragmented ruling coalitions; and for greater decentralisation.

In every country, politics attracts some unsavoury characters, but India may be worse than most. According to research by the Public Affairs Centre (PAC), a Bangalore-based monitoring outfit, of 541 members of the lower house of parliament elected last year, nearly a quarter faced criminal charges. The proportion is higher for less educated MPs, who also tend to be richer. “Do political parties attract them,” asks the PAC, “because they compensate for their low education through their asset power and criminal prowess?”

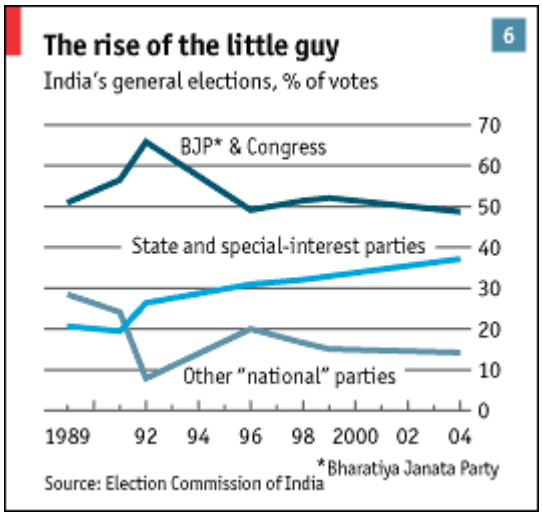
More than half of the MPs facing charges that could lead to lengthy prison sentences come from just four states in the Hindi-speaking “heartland” of northern India: Bihar, Jharkhand, Uttar Pradesh and Madhya Pradesh. In these places there is a special risk of criminals seizing political power, operating like warlords and sometimes winning election by “capturing” polling booths by force. Office holds out the chance of political protection from prosecution, as well as of income from corrupt practices.

A stalwartly independent Election Commission does its best, but it faces an uphill struggle. Late last year, for example, Laloo Prasad Yadav, the political boss of Bihar (and railways minister in the federal government), was caught on camera dishing out 100-rupee notes to crowds of poor

people, apparently to encourage them to attend a rally before the state elections in February. The Election Commission let Mr Yadav off with a “severe reprimand”.

The chief election commissioner has expressed sympathy for the idea of giving voters the option to reject all candidates on the slate, but that would achieve little beyond perhaps a healthy embarrassment. Speeding up the judicial process so that more guilty politicians spend time in jail rather than parliament would help. However, some argue that the only way to attract higher-quality candidates and ensure fair contests is to finance election campaigns with public money.

The second political obstacle to reform is the growing power of change-resistant regional and caste-based parties like Mr Yadav's. Last year's election was portrayed as a triumph for Congress over the Bharatiya Janata Party (BJP), the Hindu-nationalist party that led the previous coalition government and is now the main opposition. That disguised a more important trend. For the first time since 1996, these two big national parties won less than half of the total vote (49%). State and special-interest parties have increased their share from 21% in 1989 to 37% (see chart 6). In only one of India's six most populous states does either of the two big national parties have a majority in the state legislature.



Three ideas of India

Coalitions, which have formed the last three governments, seem likely to rule India for years to come. The present one involves more than 20 parties. This can have a healthily moderating effect. In office, the BJP, for example, had to refrain from controversial policies promoting the interests of Hindus in order to keep its coalition together. But it can lead to paralysis. The present government faces debilitating rows with its coalition partners and “outside supporters” (mainly Communists) over every reform—be it a small cut in the above-market interest rates paid to pensioners on their provident-fund accounts (subsequently withdrawn) or the permissible level of foreign investment in the telecoms industry.

Keeping coalitions together is not just a handicap in making policy. It is expensive. Lord Desai points out that the fiscal deficit grew in tandem with the decline of the big central parties. He argues that the various parties have three different ideas of India. Congress is Nehru's heir, and custodian of his vision of a united, secular, syncretic India. The BJP is the party of the Hindu majority, with a view of a proud, resurgent Hindu nation. Most of the smaller parties, however, are subnational. The Communists are hardly an exception, so geographically defined is their strength. Their appeal is to caste, regional or linguistic loyalty. Politics becomes a matter of redistributing the national cake, not baking a bigger one. Nor are voters foolish to elect them. These narrowly based parties, offering only to advance the interests of their “vote banks”, may actually be better at keeping their promises than those pledging economic development.

Lord Desai's solution is for the two parties with a “unitary” vision of India—the BJP and Congress—to work in coalition. Because each is committed to raising India's long-term growth rate, and broadly agrees on how to achieve that, this makes some sense. But because each defines itself in opposition to the other, it seems fanciful. Likewise, given the difficulty of forging consensus and of persuading politicians to acquiesce in loss of power, some of the ideas floated by members of the present government seem unrealistic. Prithviraj Chavan, for example, a minister in the prime minister's office, has suggested laws limiting the number of parties contesting national elections. Salman Khurshid, another Congress leader, has proposed introducing some proportional

representation into the electoral system, with candidates chosen from a national list.

However a government is elected, it is likely to suffer from corruption. Rajiv Gandhi, a prime minister in the 1980s, once said that, of every 100 rupees of public money spent on the poor, only 15 ever reach them, and he is still often quoted. Many argue that the best way to monitor the graft of elected and non-elected officials is to devolve decision-making—and funds—to the lowest levels of elected government, the village councils or *panchayats*. Efforts to do so in the past have often been thwarted by the vested interests under threat. This government has promised a renewed effort.

If political reform in India seems daunting, in China it is life-threatening. There has been some change at local level. Elections have been held in villages and in some urban districts, and in some party and state bodies. Meanwhile a proliferation of new outlets and growing internet usage have broadened the scope of allowed discourse. But the party has never contemplated relinquishing its monopoly on power.

Two million mutinies now

Hopes that Hu Jintao, who took over as the party's leader in 2002, might usher in a period of faster political change have been dashed. Mr Hu has ruled out a separation of powers on the western model. According to Tony Saich, a China expert at the Kennedy School of Government at Harvard, he clings “to the belief that the answer lies in improving the quality of local officials and instilling in them a more upright, moral vision of what a good official should be”. As Mr Saich points out, this is in all but name a Confucian notion: “the rectification of names”.

How fragile does this rigidity leave China? There are plenty of causes for disaffection: inadequate compensation for farmers' requisitioned land; no work and no welfare system for migrant labourers; large-scale corruption; and sharply rising inequality. According to police statistics, the number of public protests in China in 2003 averaged about 160 a day. The protests in 1989, and later the mushrooming of the Falun Gong cult, showed how quickly popular enthusiasms can spread. But the party has made sure it faces no national opposition that might join these isolated protests into a co-ordinated movement.

Mr Saich oversaw a survey in 2003 in which people were asked about their level of satisfaction with the government. They grumbled about local authorities, which are responsible for delivering services and often fail. But on the whole they were happy with the central government. This suggests it is given some credit for its national role: it is guiding China to great-power status. It will remind its people, and the world, constantly of this as it prepares to play host to the 2008 Olympic Games.

Sooner or later, however, the party will have to loosen its grip. Optimists argue that a number of countries have managed impressive “catch-up” growth under authoritarian systems—for example, Germany, Japan and the Soviet Union. One could add Taiwan and South Korea. But none has stayed in the first rank without democratising. Leadership demands innovation. And, for all its failings, democracy is better at producing that.

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Rivals and partners

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Are India and China coming together?

AN UNSTATED assumption of this survey has been that India and China are rivals. That is certainly the way it seems from India. In economic growth, global influence and military might, India cannot help but measure itself against its neighbour. Ever since China's rout of India in a brief but bloody war in 1962, this comparison has been tinged with a sense of injustice, humiliation and suspicion.

But this is a rather one-sided competition. India desperately wants the international standing and respect that China already enjoys. In particular, it wants this status symbolised, as China's is, through a permanent, veto-wielding seat on the United Nations Security Council. If China measures itself against any country, however, it is America.

Its relationship with India, moreover, is changing: diplomatic relations are better than at any time since 1962, and trade is booming. The two civilisations have cultural, religious and trading links dating back 2,500 years. They are not doomed to be enemies. So is this the dawn of a new era of partnership and co-operation, the creation, as some suggest, of an “India-China nexus” that will change the world?

There are strong grounds for scepticism. First, Indian suspicions of China run deep, and the disagreement that caused the war still looms large. Usually labelled a “border dispute”, it is not some minor cartographic tiff. India claims an area of Chinese-controlled territory in Ladakh, Kashmir, that is the size of Switzerland. China's claim to what is now the Indian state of Arunachal Pradesh covers an area three times bigger (see map). Since 1988, working groups have been meeting to discuss the dispute. Their main aim has been not so much to reach agreement but to

shelve the issue, allowing relations to improve in other areas.

New impetus was injected, however, when Atal Behari Vajpayee, then India's prime minister, visited China in 2003. Talks on the border dispute were moved to a much higher level. A settlement involving swapping claims and making some minor border adjustments still seems remote, because of the political difficulty of selling such a deal in India. But it is no longer inconceivable.

Beijing University's Jia Qingguo argues that a renewed Chinese interest in India was in part provoked by America's attempts under the Clinton administration, and, until September 11th 2001, under George Bush as well, to “use India to contain China”. Kishore Mahbubani, a Singaporean former diplomat who now heads the Lee Kwan Yew School for Public Policy, makes a similar point: that China is “buying political insurance now” through all its neighbours. It knows America will be alarmed by its emergence as a great power and, far-sightedly, wants those neighbours to share in its prosperity.

China's “all-weather” friendship with Pakistan has always complicated relations with India, though China has long stopped voicing explicit support for Pakistan's stance on Kashmir, and appears to have played an important role in 2003 in persuading it to start serious peace talks with India. But some Indian analysts still point to China's “strategic encirclement” of India—ie, its attempts to make friends with all of India's neighbours, from Sri Lanka to Myanmar. When India became a declared nuclear power in 1998, Mr Vajpayee wrote to President Clinton to explain his reasons for the move, citing “an overt nuclear weapons state on our borders, a state which committed armed aggression against India in 1962”. China, which had reacted calmly to India's bomb, was peeved at being used to justify it.

Chinese officials implied that, if India wanted an arms race, China was ready. Such sabre-rattling has died down since then. But as China's economy grows, it will probably want an army to match its economic might. India may find it hard to believe that Chinese intentions are benign. One Chinese scholar sees similarities between Indian attitudes to China and Chinese attitudes to Japan. The animosity in Sino-Japanese relations is far more deep-seated, but there is the same mixture of historical grudge and present envy.

India and China may also find themselves in competition for resources, especially energy. In the period up to 2020, Chinese demand for oil is expected to grow by almost as much as America's in absolute terms. India is also dependent on imported hydrocarbons, and is hungrily seeking long-term supplies of oil and gas. In one sign that the two countries might co-operate as well as compete, India in January announced it had acquired a 20% share in the development of Iran's biggest onshore oilfield, which is operated and 50% owned by Sinopec, China's state-owned oil company.

Corbis

As relations have improved, there has been much talk about the “complementarity” of the two economies. With Indian software and Chinese hardware, goes the refrain, the world will be at our feet. Looked at from the perspective of American multinationals, shifting some of their manufacturing to China and some of their back-office processes to India, this makes some sense. But its application to direct Sino-Indian economic exchanges seems limited for now.

Fast as they are growing, these are still small. The two countries' bilateral trade, in which India enjoys a surplus, has been growing by leaps and bounds, to reach $13 billion in 2004. But that is just 1% of China's global trade, though 9% of India's. There are only seven direct flights a week between India and China, compared

with, for example, six a day between Shanghai and Bangkok alone. In 2003, of the 11.4m tourists who visited China, just 211,000 were Indian; and only 21,000 Chinese visited India.

Investment flows are still small. Huawei, a Chinese telecoms-equipment firm, employs several hundred software engineers in Bangalore. Chinese white-goods makers such as Hai'er are fighting for market share in India. In the other direction, Indian software firms are setting up in China, and some firms are manufacturing there.

Indian companies' interest in China (like that of many multinationals) remains focused mainly on export markets, or on the foreign sector within China. Tata Consultancy Services, for example, India's biggest software firm, has a development centre in Hangzhou where it employs some 200 people. Its regional director, Girija Pande, says it was drawn to China by the needs of its multinational clients. Only a small proportion of its work there is for Chinese customers.

Nehru couldn't make it fly

Similarly, in manufacturing, Orind Refractories, an Indian firm that has been making refractory bricks for steel furnaces in China's north-eastern Liaoning province for ten years, exports 98% of its output, despite a huge demand for the bricks in China itself. Competing with local firms is hard, and getting paid is even harder.

First Eastern, a Hong Kong-based private-equity firm that has invested in 80 projects in China, is planning to launch a $200m fund to invest in Indian ventures in China, Chinese projects in India and joint ventures in third countries. Victor Chu, First Eastern's boss, says the aim is “to realise the largest potential synergy” in Asia. He sees opportunities in, for example, pharmaceuticals, and Chinese tourism to India. One Indian pharmaceutical firm, Ranbaxy, has been manufacturing in China since 1995, and outbound tourism is growing fast.

From such a low base, it would be surprising if two-way trade and investment flows did not increase rapidly. But China is becoming so integrated with the rest of the global economy that it is hard to see how its business with India alone will make a huge difference.

Panos

Soft and hard

India and China will have what Mr Chu calls a “competitive partnership”. In India, the Chinese bogey is constantly invoked as the biggest potential threat to India's lead in exports of IT services and outsourcing. China, it is argued, is only a few years behind in producing similar numbers of software engineers and of English-speaking graduates. Such is its clout in the global economy that it will prise India's one undisputed niche away from it.

Useful though such warnings may be in keeping Indian firms on their toes, they seem a bit far-fetched. Some outsourcing operations, such as call-centres, are already setting up in China. GE Capital International Services, an India-based back-office-services firm set up by General Electric, is one of several firms with operations in Dalian in China's north-east, where it employs more

than 1,000 people. From there, it can provide services both to China and to Japan and Korea.

In those markets, Indian IT-services firms will certainly find themselves at a disadvantage. But in services requiring fluent English-speakers, it is likely to retain its lead for a long time yet. The same applies to software. The Chinese software industry is fragmented, focused on its domestic market and inexperienced in dealing with the complex collaborative development projects in which Indian firms excel.

The next China?

The more interesting and important question is whether India can compete with—or at least emulate—China in labour-intensive manufacturing for export. There is no other way that Indian economic growth can be raised consistently to match that achieved in China in the past two decades. Some Indian manufacturers remain in awe of China's ability to grab and dominate a market. Rahul Gupta, managing director of Phoenix Lamps near Delhi, for example, says that in one of his firm's products, compact fluorescent lamps, China has 65% of the global market. China's role as the global economy's manufacturing hub is unstoppable, and India has “missed the boat”.

Phoenix refuses to compete head-on with Chinese lampmakers. Their prices are unbeatable. Mr Gupta, and many others, attribute this to a variety of open and hidden subsidies: an undervalued exchange rate, cheap credit with few penalties for default, underpriced land, unpaid suppliers' bills, export subsidies and so on. Phoenix's response has been to move upmarket and compete on quality in less price-sensitive markets.

That has been the story for many of India's successful exporters. But is the battle for the bargain basement really lost? Orind's boss, Rajeshwar Mishra, for one, is optimistic that, within two to three years, India will be more attractive to manufacturers than China is. Rising labour costs in China will force them to look elsewhere.

India hopes to be, in a phrase often heard, “China 15 years ago”: on the point of becoming an export powerhouse. Hong Liang, an economist with Goldman Sachs in Hong Kong, says that, even in China, this idea is attracting attention. Policymakers have noticed, she says, that the emergence of China as a lower-cost competitor was a proximate cause of South-East Asia's financial crisis in 1997. Looking around for the source of such a threat to China, India is the obvious candidate.

As this survey has argued, India is not going to play that sort of role without radical change. Many think it will never happen, and argue that this does not matter: India is doing very well, growing faster and lifting more people out of poverty than ever, against a political and social backdrop immeasurably more complex than China's. The comparison is pointless; the two countries are just too different.

That may be true. But India needs to raise its growth rate not as part of some artificial race with China, but for its own sake. Because of its population profile, not to do so would bring a big rise in unemployment, with all the misery that implies. The obstacles are certainly daunting, and include some political reform. Elections in February in Bihar, India's most backward state, and the one where crime and politics have become least easily distinguished, served as a reminder of how difficult that will be in India's federal system. The growth of parties relying on particular lower-caste groups for their votes has led to unwieldy and often ugly coalition politics. But in a democracy, that is not a reason for making it harder for such parties to share power.

One consequence of this may be to widen the gap between the richest parts of India and those, like Bihar, that have been left behind. In both India and China, one of the big challenges of the next few years will be managing regional differences. Just six of India's 29 states attract almost all the foreign investment that comes into the country. China faces a comparable gap between its booming coastal provinces and the poorer interior. But its central government is better able both to dictate provincial policy and to invest in its backward western regions.

How the two countries cope with these and other social tensions will in part determine whether they can maintain or (for India) raise their present high rates of growth. China does not have the safety valve of regular competitive elections, but nor are there signs of an imminent explosion. India's political structure has shown itself well able to absorb all manner of shocks, but not, as yet, to achieve sustained radical growth-enhancing reform. Many would agree with Lord Desai's conclusion: “China will again become a viable Great Power; India may become just a Great Democracy.”

It is worth recalling, however, that when India launched its reforms, in 1991, the future of China's reforms was itself in doubt. After the Tiananmen protests in 1989, there was renewed infighting within the Communist Party about how far and how fast to push “reform and opening”. It was only Deng Xiaoping's “southern tour” in early 1992 that decided the debate conclusively in favour of a rush for growth.

India's position now is broadly similar. Economic reform has worked, as it did in China, but the country continues to face resistance from vested interests. Last year's election, seen as a rebuff to the politicians by the neglected rural poor, is sometimes interpreted as a vote against reform. But it was largely a vote against non-performing governments and, in that sense, a ringing call for more radical change. It showed that Indian voters understand the essential truth that Deng grasped about pre-reform China: “The old stuff didn't work.”

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Europe's defence industry

Taking aim, again

Mar 3rd 2005 | LONDON AND PARIS
From The Economist print edition

DGA

Six years after the last wave of consolidation, Europe's defence companies are looking at merger targets again

BACK in the early 1990s, when America cut defence spending at the end of the cold war, rationalisation of its defence industry proved relatively easy. The Pentagon gathered industry chiefs for a “last supper”, as it was later called, and within a few years 15 defence contractors had shrunk through mergers to five. Europe found such a big consolidation tougher, because politics got in the way. But a few stealthy mergers went ahead, and now another effort could be getting underway.

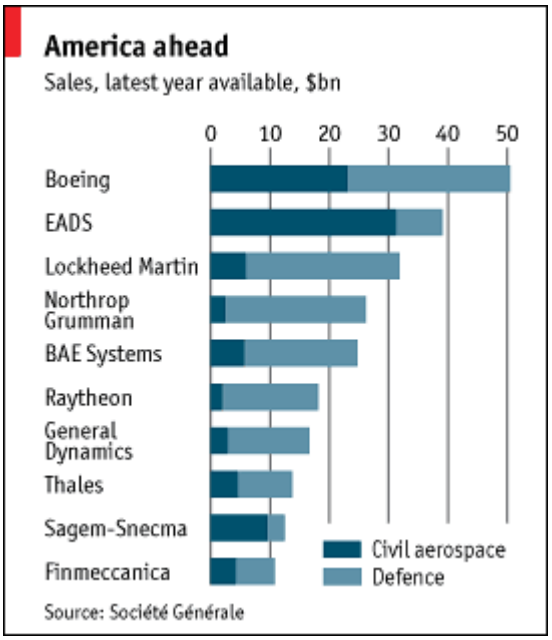
The last time around Europe was left with minnows compared with America's defence giants. Europe's leading defence aerospace company, EADS, has only attained the size of Lockheed Martin and Boeing by virtue of the runaway success of its civilian Airbus passenger jets (see chart). Even a gigantic £13 billion ($25 billion) in-flight refuelling contract for Britain's RAF, won this week by EADS (plus firms such as Cobham and Rolls-Royce in a consortium), is using converted Airbus A330 widebody jets. They will be fitted with nozzles to become petrol stations in the sky, when needed, and at other times they will be leased as civilian passenger jets (the petrol tanks are in the huge wings).

An Anglo-German marriage of British Aerospace (now BAE Systems) and Daimler-Benz's DASA collapsed acrimoniously when the British jilted DASA at the altar and ran off in a tie-up with GEC-Marconi, in a thoroughly British deal. Furious, the Germans quickly found consolation in the arms of Aerospatiale Matra, a partly privatised French group. Thus was born EADS, which is owned 30% by the French (half shares each to the government and the Lagardère conglomerate), 30% by

DaimlerChrysler and 6% by SEPI, the Spanish government's industrial holding company. The remaining 34% is publicly traded.

EADS already represents quite a consolidation for Europe in that it is now a tri-national company. Other mergers include Thales, a French defence-electronics company that became Franco-British after buying Racal. It now has 11,000 employees in Britain and wins local contracts. Britain's Ministry of Defence has fostered Thales to provide competition to BAE Systems, with which it has rowed for years about cost over-runs and contract delays. Thales already makes 10% of its sales in Britain and that could grow. It will design new aircraft carriers for both France and Britain, and the company is a member of the group that won this week's RAF deal.

Another quiet move towards consolidation is represented by Italy's Finmeccanica, which in five years has gone from being a state-owned financial-holding company to a mostly-privatised industrial group concentrating on aerospace and defence. Since it bought Westland helicopters from Britain's GKN late last year, Finmeccanica has become an Italo-British group, with some 10,000 employees in Britain. In January it bought part of BAE Systems's defence communications and avionics businesses. Then there is the €4.9 billion ($6.4 billion) merger of two French defence aerospace companies, SNECMA (which makes jet engines) and SAGEM, an electronics group, though this is a combination pushed by the government as part of its privatisation programme and makes little industrial sense.



Europe's defence companies need to get bigger. The five leaders still fight over military budgets that add up to less than half the $150 billion or so that America spends on new equipment (mostly in defence aerospace) each year.

To get more scale and satisfy jealous national governments, who want defence spending to create jobs at home, Europe has turned to joint ventures, such as the consortium that makes the Typhoon, which started life as the Eurofighter plane. This brings together BAE Systems, EADS and Finmeccanica, but excludes the French who insist on plugging on with their own Mirage and Rafale fighters. The other notable tri-national joint-venture is the MBDA missiles company, which brings together BAE Systems, EADS and Finmeccanica.

Now there is a flurry of interest in further mergers. Impatient at its slow progress in defence,

EADS bosses (encouraged by the French government) wanted late last year to buy Thales, a quoted company which is owned 31% by the French government and 9% by Alcatel, a struggling French telecoms-equipment firm in need of money. For the government, this would have had the distinct advantage of turning EADS into a more French company than the Franco-German partnership it has been since its creation. But Thales's boss, Denis Ranque, was less than keen. And DaimlerChrysler, as an EADS shareholder, was opposed to buying a French company. EADS plus Thales would have been bigger than Boeing.

The latest buzz is that Thales and Finmeccanica might merge to become the biggest defence-electronics combine in Europe, and a big force overseas. But because the French and Italian governments still own around 30% of each firm, their approval would be necessary. Given the Paris preference for a grand Frenchification of EADS through a takeover of Thales, its permission seems unlikely—even if the Italians warm to a deal.

Meanwhile, EADS could become more French in another way. Noël Forgeard, boss of Airbus, which provides the bulk of EADS's sales and virtually all of its profit, is to become co-chief executive of EADS alongside a German, Tom Enders. But Mr Forgeard, who wanted to become sole CEO, is manoeuvring to keep oversight of Airbus, thus making him a much more powerful figure than Mr Enders, and cementing French influence in the company.

DaimlerChrysler could insist on the French government selling its EADS shareholding to counter French influence. Indeed, the whole shareholding structure of EADS looks unstable. The Lagardère group is due to sell its holding within a few years to concentrate on media. DaimlerChrysler is likely to sell its 30% stake sooner or later to concentrate on its car businesses. Tellingly, Arnaud Lagardère, boss of the eponymous group, has joined the board of DaimlerChrysler, adding fuel to rumours of a co-ordinated sell-off by EADS's big shareholders.

Adding to the prospect of wholesale change is the probability that BAE Systems will sell its one-fifth stake in Airbus (EADS owns the other 80%) in order to finance a big acquisition in America. BAE Systems is growing fast on the other side of the Atlantic; it has sales of $5.6 billion and 25,000 employees there. Last year it bought another five small American companies, even as it sells European assets, such as its half stake in Saab Aircraft and a joint-venture with Finmeccanica. It is also a big partner of Lockheed Martin in the F-35, a joint strike fighter and the world's biggest military project with potential sales of $200 billion. Having turned its back on a big European merger last time, BAE Systems seems determined to sit out the continental skirmish once again.

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European carmakers

Driving out of the east

Mar 3rd 2005 | GENEVA
From The Economist print edition

More production moves to eastern Europe

EPA

And from the chilly East...

PEUGEOTS, Citroëns and Toyotas started rolling off the line of a new factory at Kolin in the Czech Republic this week. At full tilt, the plant will turn out 300,000 vehicles a year. The Peugeot 107, Citroën C1 and the Toyota Aygo are three different badges for an economical car aimed at the bottom of the market. PSA Peugeot Citroën also has a new plant opening in Slovakia, as does Kia, a brand now owned by South Korea's Hyundai. And Japan's Suzuki is expanding in Hungary. Central and eastern Europe (including Turkey) now has 24 car-assembly factories, plus many smaller plants turning out components.

Output in the region is still barely 3m compared with total European output of 18m cars last year, but J.D. Power-LMC, a market-research group, says it grew by 27% over the past five years, while output stayed flat in the traditional carmaking areas of western Europe. Already Russia, the biggest producing country in central and eastern Europe, has overtaken Italy to become the fifth-largest carmaking country in Europe.

The first wave of investment by western car firms was to satisfy local demand. Now much of it is for export to western Europe. In June, Renault will export its little Logan saloons, made by its Dacia subsidiary in Romania. Industry leaders, such as Jean-Martin Folz, chief executive of Peugeot, and Louis Schweitzer, chairman of Renault, pointed out some time ago that the Toyota factory at Valenciennes in northern France, opened in 2001, will be the last new car-assembly factory in western Europe.

Cheaper labour costs are the obvious attraction. Mr Schweitzer says Renault cannot profitably sell a car built in western Europe at a price below €7,500 ($9,825): but a Renault from the East can

turn a profit at €5,000. Likewise, one of the new models that should help troubled Fiat is a Polish-built Panda.

Car companies have horrendous problems closing car factories in the West, so this will not result immediately in factory closures there. But they are bound to happen eventually, as the industry strives to reduce overall capacity. Meanwhile most companies are putting pressure on their suppliers to move production to the East as well. This would reduce the cost of the bought-in parts that account for about 70% of the cost of a car. Plants making parts are smaller and less high-profile than assembly lines, so closures of parts factories in the West could happen sooner.

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Telecoms equipment

See Huawei run

Mar 3rd 2005
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How much of a threat are China's big suppliers?

Reuters

Hooray for Huawei

THE aggressive push into international markets by Huawei, China's leading telecoms-equipment manufacturer, appears to be bearing fruit. In December, Huawei won an estimated $100m contract to build a third-generation (3G) wireless network for Telfort, a Dutch operator that has always used gear from Ericsson, the world's largest telecoms-equipment firm. In January, Huawei won a $187m order for another 3G network, in Thailand, beating Ericsson and Motorola with a bid 46% below the operator's original estimate.

Last week came evidence that Huawei can compete on more than just price. A report based on a survey of over 100 telecoms operators worldwide, carried out by Heavy Reading, a market-research firm, found that Huawei ranked eighth among wireline-equipment suppliers, up from 18th last year. (Cisco came top.) Most strikingly, Huawei ranked fourth in service and support. The report calls Huawei's ascendancy “astounding” and says it has already surpassed several incumbent vendors in perceived market leadership.

As a result, incumbent western firms should be “very scared” of Huawei, says Jean-Charles Doineau of Ovum, a consultancy. Huawei's reputation as a low-cost vendor is only the visible part of the iceberg, he says. Below the waterline, the company has high technical standards, though it is not known for its ability to innovate. It also has a 30% share of the vast Chinese market, equivalent in size to Europe's. Having developed products at the behest of its demanding domestic customers, Huawei can then sell them elsewhere.

Big ambitions

Initially, Huawei concentrated on developing countries, but it is now gaining traction in the developed world, in Europe in particular. Last week it was named a key supplier by COLT, a British operator, and also won a $100m broadband contract from Optus, an Australian firm. Huawei has yet to win the endorsement of a first-tier operator, but its gear is being evaluated by BT, Britain's incumbent operator, and by Vodafone, the world's largest mobile operator. BT is expected to announce the suppliers for its new “21st Century Network” soon, and Huawei is on the short list. Arun Sarin, Vodafone's boss, says his firm is watching Huawei closely.

Much of Huawei's competitiveness derives from its low labour costs. Richard Lee, a company spokesman, says Huawei can pay its senior engineers a quarter of the going rate in the developed world, and junior engineers just an eighth. The question, says Jason Chapman of Gartner, a consultancy, is how sustainable that advantage will prove to be as Huawei moves into international markets. Its regional affiliate in the Netherlands, set up to support the Telfort deal, for example, will have to pay developed-world wages. Mr Lee responds that, so far, only 3,400 of Huawei's 24,000 employees worldwide are non-Chinese, so the firm will continue to have a cost advantage for several years.

That said, it must catch up in other areas, says Mr Doineau. While Huawei is very competitive on price and technical specifications, equipment providers do more than simply deliver boxes to service providers: they also have to be able to deploy entire networks. Huawei has done that in some parts of the world, often by flying in armies of engineers, but in the long term it needs local affiliates. “They need to build that before they can be compared to Ericsson,” says Mr Doineau. Huawei is also criticised for its opaque finances—it remains a privately held company—and for its supposed links with the Chinese government. Mr Lee responds that Huawei is striving to be more transparent in order to build its brand. Tellingly, the firm will hold its analysts' event in Europe for the first time this year.

Its developed-world rivals, meanwhile, are responding to the threat from Huawei, ZTE and other Chinese firms by forming partnerships and moving research and development, as well as manufacturing, to China and other low-cost economies, both to reduce costs and to gain access to local markets. Bill Owens, the boss of Nortel, a Canadian equipment-maker, says the Chinese vendors are “quality competitors”. Nortel already outsources all its manufacturing, and has just formed a joint-venture with China Putian to develop 3G gear.

The upshot is that although Huawei is very different from its foreign rivals today, those differences will diminish in the coming years. As it advances into western markets, Huawei is having to become more like a western firm; and in order to compete with the likes of Huawei, western firms are having to become more Chinese. “The gap is narrowing,” says Mr Lee.

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China's internet

Game on

Mar 3rd 2005 | HONG KONG
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A takeover battle begins

ONE online game, which is popular with millions of Chinese, forces players to choose between fighting or co-operating with monsters to preserve their own race. In the real world, Shanda Interactive Entertainment, the propagator of “The Legend of Mir II”, faced a similar dilemma. And its decision has upset its own industry's delicate balance.

On February 18th, Shanda, China's top internet company, revealed that it had snapped up 19.5% of Sina.com, the biggest of the country's three big web portals, for $230m. A Shanda spokesman says the company wants control. This is unusually aggressive in a country where hostile takeovers among domestic firms are unheard of. And it triggered a swift response: Sina soon scored another first for China by putting in place a poison pill, which allows it to issue enough stock to dilute an unwelcome shareholder's stake.

The shift in emphasis from headlong growth to consolidation speaks volumes about the increasing maturity of the mainland's internet sector. The potential seems big. China had 94m web users at the end of last year, up from 80m in 2003, but still only 7% of the population. Their number could overtake America's 185m internet users within five years. Yet competition for (relatively thin) wallets is increasing, fashions are fickle and state regulators are increasingly meddling in an industry that has captured their imaginations.

Sina, with news, a search engine and auctions, offers Shanda a broader business. So when a government ban on the advertising of Sina's fortune-telling phone-message service hammered its share price, Shanda swooped. Their merger would create a group with estimated 2005 revenues of $470m and a $3.9 billion market value.

Unless a foreign firm steps in: eBay, which bought mainland auction site EachNet in 2003, and Yahoo! which bought 3721 Networks, a local search engine, are clearly willing to buy internet firms in China.

But China's internet firms may not be much of a guide to the broader potential for hostile takeovers. They are a rare breed. Founded by entrepreneurs and privately owned, the top half a dozen, including Shanda and Sina, are also listed on America's NASDAQ stockmarket. That makes them very different from the bulk of listed Chinese firms, in which the government or an unlisted parent retains a decisive stake. Even among this select group, Sina stands out. Unlike Shanda and fellow portals Netease and Sohu.com, which are controlled by their founders, it has a fragmented shareholder base, opening it to a hostile bid. Until the state shareholdings in many Chinese companies are sold—which will only happen slowly—there is limited potential for unfriendly raids.

Nor would the government necessarily tolerate them. Even if it cannot directly decide the outcome of a putative bid, the Communist leadership is enormously sensitive about the ownership of online

media and has huge influence as regulator and censor. It could encourage or block certain combinations or organise a domestic solution—such as a rescue by Tom Online, the internet company of Hong Kong tycoon Li Ka-shing. That would hardly be fair play in China's brave new capitalist world. But then when it comes to gaming the market, Beijing still holds most of the cards.

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Identity theft

What's in a name?

Mar 3rd 2005
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Collecting, and stealing, personal information is big business

PLATO asked “What is man?” and St Augustine asked “Who am I?” A new breed of criminals has a novel answer: “I am you!” Although impostors have existed for ages, the growing frequency and cost of identity theft is worrisome. Around 10m Americans are victims annually, and it is the leading consumer-fraud complaint over the past five years. The cost to businesses was almost $50 billion, and to consumers $5 billion, in 2002, the most recent year that America's Federal Trade Commission collected figures.

After two recent, big privacy disasters, people and politicians are calling for action. In February, ChoicePoint, a large data-collection agency, began sending out letters warning 145,000 Americans that it had wrongly provided fraudsters with their personal details, including Social Security numbers. Around 750 people have already spotted fraudulent activity. And on February 25th, Bank of America revealed that it lost data tapes that contain personal information on over 1m government employees, including some Senators. Although accident and not illegality is suspected, all must take precautions against identity theft.

Faced with such incidents, state and national lawmakers are calling for new regulations, including over companies that collect and sell personal information. As an industry, the firms—such as ChoicePoint, Acxiom, LexisNexis and Westlaw—are largely unregulated. They have also grown enormous. For example, ChoicePoint was founded in 1997 and has acquired nearly 60 firms to amass databases with 19 billion records on people. It is used by insurance firms, landlords and even police agencies.

California is the only state with a law requiring companies to notify individuals when their personal information has been compromised—which made ChoicePoint reveal the fraud (albeit five months after it was noticed, and after its top two bosses exercised stock options). Legislation to make the requirement a federal law is under consideration. Moreover, lawmakers say they will propose that rules governing credit bureaus and medical companies are extended to data-collection firms. And alongside legislation, there is always litigation. Already, ChoicePoint has been sued for failing to safeguard individuals' data.

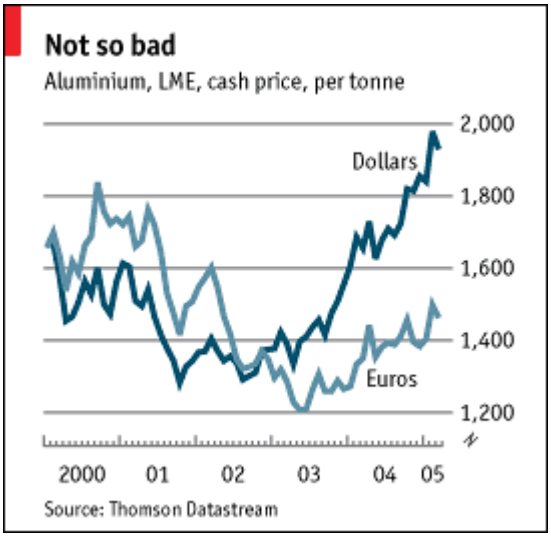
Yet the legal remedies would still be far looser than in Europe, where identity theft is also a menace, though less frequent and costly. The European Data Protection Directive, implemented in 1998, gives people the right to access their information, change inaccuracies, and deny permission for it to be shared. Moreover, it places the cost of mistakes on the companies that collect the data, not on individuals. When the law was put in force, American policymakers groaned that it was bad for business. But now they seem to be reconsidering it.

The aluminium industry

Light tears

Mar 3rd 2005
From The Economist print edition

Power prices trouble Europe's smelters



WILL high energy costs force half of Europe's aluminium-smelting plants to close within a few years? That is what the industry is telling the European Union and national governments. It wants them to twist arms in the electricity industry to prevent this happening—and in France, where such arm-twisting is still the norm and the state owns the main power generator, it has met some sympathy.

Does it deserve any, when even in euro terms the smelters' output price has risen a quarter since its 2003 low? “Primary”—brand-new—aluminium starts (typically, in Australia) as bauxite. About five tonnes of that are chemically refined, usually near the mine, into two of alumina, an aluminium oxide. This is smelted, by passing a huge current through it, into one tonne of almost pure metal, at a cost of 15 megawatt hours (MWh) of electricity. This is not a problem for smelters with access to cheap electricity such as hydropower, which explains Norway's 1.2m-tonne output. But most smelters rely on long-term contracts with generators which have rival customers, and some of these contracts—notably those in Germany and the Netherlands, which smelt about 1m tonnes between them—are due soon for renewal. The smelters fear price rises of up to 40%.

American-owned Alcan, rival to Alcoa for the world's top spot, is gloomy. In 2003 it added Pechiney, a big French producer, to its European stable, which now produces over a quarter of western Europe's 4.5m tonnes. If prices rise above $30 per MWh in Europe, it reckons, its plants cannot survive. A small plant in France and a big Dutch one are both under threat.

These are surprisingly low figures: the European Aluminium Association claims members are already paying around €30 ($40); equivalent to some $600 per tonne of fresh aluminium. But even at that level, is electricity the real problem? An extra $10-15 per MWh would add $150-225 to the cost of each tonne of aluminium. But a bigger factor these days is the raw material, alumina. For years its spot price drifted around $200 a tonne, ending 2002 near $150. Then came world recovery and the Chinese. At one moment last year, the spot price hit $530, before diving below $300 as Chinese demand slowed. An Indian supplier this week sold alumina at around $420—ie, $840 per tonne of aluminium.

Spot prices are not long-term contract prices and alumina prices could fall again as the bauxite refiners' capacity rises. This will depend on aluminium demand and prices. Around half of all aluminium goes into vehicles and buildings, competing with steel. Just as steel demand and prices have soared, thanks notably to China, so have those of aluminium. It has risen $200 a tonne—matching those threatened future power-price rises—in the past six months.

If Chinese demand persists, high prices probably will too. Alumina suppliers—which include, not least, vertically integrated Alcoa and Alcan themselves, China's Chalco and the alumina arm of Russia's Rusal—will rejoice. The smelters will survive. The end-users will pay up. Power prices are a genuine long-term worry for the smelters. But the real challenge now is one familiar to many similar industries: raw material costs and the state of the end-market. And, in Europe—which is why the cries are coming from there—forex markets and the strength of the euro.

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Outsourcing

Time to bring it back home?

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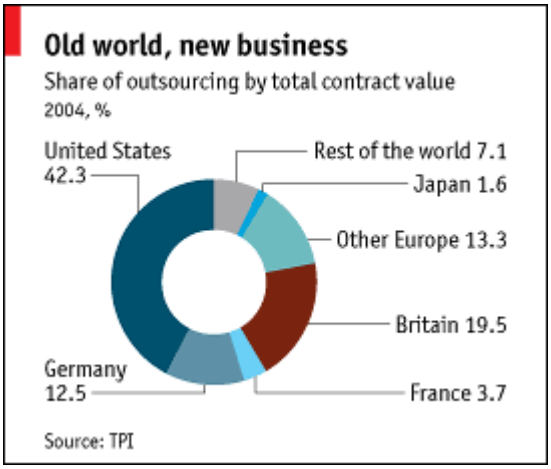
Outsourcing has its limits



THE two consortia shortlisted for the biggest outsourcing contract in Europe this year had to bite their nails this week. According to weekend reports, the £4 billion ($7.6 billion) ten-year contract to manage 150,000 computers and networking software for British military personnel had been won by the Atlas consortium led by EDS, a Texas-based company that has a similar contract with the US Navy. But Atlas had to wait until March 2nd before the British government announced that it had won against the rival Radii consortium, led by another American company, CSC.

Europe is now the world's biggest market for outsourcing, according to TPI, a leading adviser on sourcing. In 2004 Europe accounted for 49% of the value of all new contracts worth more than €40m ($50m); the US for only 42% (see chart). The British market is well established, but outsourcing is relatively new to continental Europe, which has taken to it with enthusiasm. TPI reckons that last year Germany accounted for 12.5% of the world market, compared with next to nothing in 2001. As in other countries, the move is being led by the financial-services industry.

The “Big Six” outsourcing firms—Accenture, ACS,CSC, EDS, Hewlett-Packard and IBM—are all American. As the market has moved to Europe, their market share has shrunk. TPI reckons that it fell by almost two-fifths in 2004, with ACS the only one of the six to have increased its share during the year. Although the two consortia bidding for the British defence contract were both led by Americans, they had carefully selected European partners: in Atlas's case the Anglo-Dutch firm LogicaCMG and a British subsidiary of the defence group EADS; in Radii's case, British Telecom and Thales.

The growth in Europe has helped the continent's home-grown outsourcing providers—companies such as Germany's Siemens and the French group Capgemini. Last year Capgemini announced a

$3.5 billion deal with TXU Corp, a Dallas-based energy company, proving that European firms can now compete in the Big Six's own back yard.

The outsourcing business has spread far from its origins setting up and running other people's IT systems. The fastest-growing part nowadays is the non-IT stuff, referred to as BPO (business-process outsourcing), where third parties provide companies with services such as finance and accounting, human resources, and design and engineering. The outsourcing business is now about two-thirds IT-related and one-third BPO.

Since the beginning of this year both Accenture and EDS have created new posts to head their firms' global BPO businesses. Kevin Campbell, the man appointed to the job at Accenture, says it could be a $500 billion market within five years. BPO is higher up the outsourcing evolutionary chain, and potentially more profitable for suppliers. But they will have to be careful how they price their services. Several have severely miscalculated the cost of the big long-term contracts common in the industry. EDS's contract with the US Navy, which involved consolidating 70,000 different IT systems, has left the Texas company $1.5 billion in the red, a sum it hopes to be able to recoup over the remaining life of the contract. To reduce the chance of similar mishaps, US Navy personnel have been involved in the negotiations with Britain's Ministry of Defence.

As with IT, the early demand for BPO came from the financial-services industry, but business is now spreading elsewhere. There is demand from automobile and aerospace manufacturers to outsource engineering and design work. But the fastest-growing business area is human resources. To consolidate its position in this market EDS has just set up a joint-venture (85:15) with Towers Perrin, a leading firm of human-resource consultants. Last year Hewitt Associates, one of Towers Perrin's main rivals, merged with Exult, a human-resource outsourcing specialist.

Future growth in outsourcing is going to be harder to find. The business is coming up against more and more objections from politicians and unions, especially when “offshoring” is involved—ie, when the outsourced work is sent abroad, as it is in roughly half of all deals. Last year two American states—Illinois and Tennessee—passed legislation aimed at limiting offshoring; this year 16 other states are considering bills that would limit state aid and tax breaks to firms that outsource abroad.

Objections raised

Moreover, companies are increasingly dissatisfied with the practical realities of outsourcing. A recent survey by Bain & Co, a firm of consultants, found that a hefty 82% of large firms in Europe, Asia and North America are today using outsourcing firms, and 51% are outsourcing offshore. But almost half say that their outsourcing does not meet their expectations. Mark Gottfredson, a Bain consultant, says that “companies are outsourcing more and more, and enjoying it less and less.”

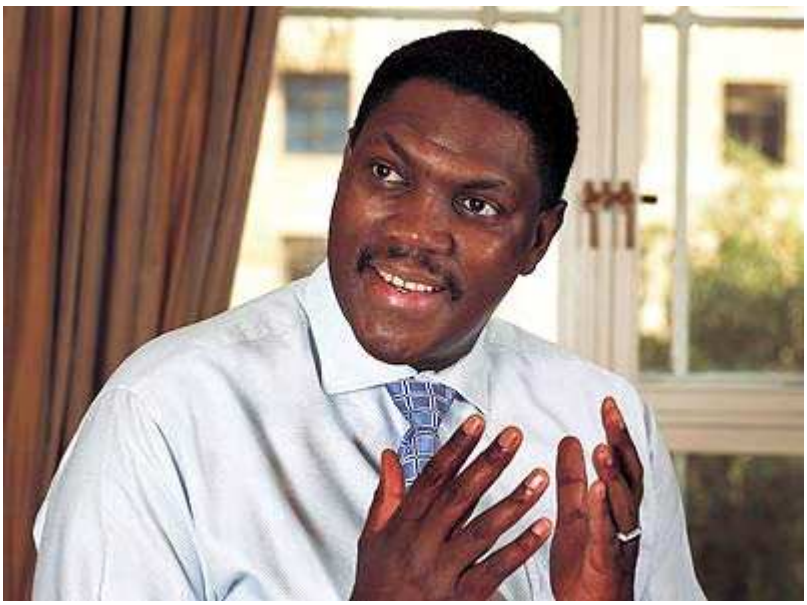
Simeon Preston of Marakon Associates, another consulting firm, says that many companies took the decision to outsource their IT operations too quickly. Non-techy chief executives were happy to pass responsibility to others for something that they neither understood nor considered to be strategically significant. The same cannot be said for the new hot areas for BPO: human resources and R&D.

Mr Preston reckons that companies that want the cost benefits from offshoring in places such as India and central Europe should think carefully before handing control of their business processes to others. After all, few companies have yet outsourced control of their manufacturing to the Chinese, even though many of their factories are in China. Why should their services be any different?

Face value

Raising Lazarus

Mar 3rd 2005
From The Economist print edition



Lazarus Zim, a politically engaged new boss at South Africa's Anglo American

THE Johannesburg headquarters of Anglo American are suitably grand for the biggest firm in Africa and one of the world's largest mining companies. Mighty stone blocks, towering pillars and a stained-glass window are topped with a sculpture of an Aryan-looking man clasping a bolt of lightning. It is a long way from Bethlehem, a grim provincial town to the south where Lazarus Zim lived in a shack and walked barefoot to school. But over at 44 Main Street, Mr Zim has just become the first black boss of Anglo American's South African operations.

Mr Zim reports only to the global boss of Anglo American, his compatriot Tony Trahar. The parent firm, listed both in London and Johannesburg, recently reported a rise in earnings of 59%, or $2.7 billion. Mr Zim sits atop a collection of South African firms—Anglo Gold Ashanti, Anglo Platinum, Anglo Coal and others—that last year contributed over a quarter of Anglo American's worldwide revenue. And that was a bad year. In 2002, when the local currency, the rand, was favourably weak, South African subsidiaries alone chipped in 42% of total earnings.

Why did he get the job? Mr Zim spent a year learning the ropes, but he is not a miner. He made his name at MTN, a mobile-phone company which flourished in new African markets such as Nigeria and Cameroon. As an outsider he is more familiar with the open offices of media firms, not the thick walls and long corridors of Anglo American. Although he got a warm welcome in the once lily-white mining house, he has also had to make an effort to learn how to operate within its stuffy corporate culture.

As an outsider, he is exactly what the company needs—especially in its efforts to patch up ragged relations with the government. “There is a very strong political element to my job, absolutely,” says Mr Zim. “This is a heavily regulated industry. We need business and government to work together.” He hopes to put an end to political sniping. Last September, President Thabo Mbeki berated Mr Trahar for saying that some political risk remains in the country. Other bosses at Anglo American have drawn official ire for publicly raising concern over various government policies.

Mr Zim needs to manage ties with the government carefully. His priority is getting existing mining rights “converted” into new ones. Previously firms owned minerals wherever they had a right to mine, but new laws describe underground deposits as state property; the government then grants rights to exploit them. “We have to show that this process works,” says Mr Zim. So far it is painfully slow: it could take another four years for old rights to be converted. This sort of uncertainty discourages investors. Although Mr Zim says Anglo American will invest nearly $4 billion in the country in the next few years, spending by the industry as a whole in South Africa is slipping.

Surveys indicate that mining firms believe other African countries, notably Botswana and Tanzania, have more welcoming laws. Miners also grumble that they are unsure what royalties the South African government will collect in exchange for licences (previously none were charged). Officials now talk of varying burdens: a few percentage points on the revenue of gold miners, more for platinum, rising to perhaps 8% for diamonds. Mr Zim expects to see legislation on this in the next few months, but nobody knows when the new royalties will be applied.

Mr Zim also needs more co-operation from state-run firms, notably the giant transport firm Transnet. Crowded railways and harbours hinder exports. Kumba Resources, a 67%-owned subsidiary, wants fast expansion of its iron ore exports, but says it needs a railway line extended. To get such things, Anglo American sorely needs a boss to whom politicians listen.

Smoother relations will also probably depend on Anglo American making faster progress with “black economic empowerment”. This means, in effect, shifting more wealth and power into black hands, something the government is desperate to speed up. Mr Zim's own appointment is a useful statement of intent, though some critics say he is merely a token black face at the top. Mr Mbeki, in his annual State of the Nation speech in February, welcomed Mr Zim's appointment as “indicating the large resources his company will spend to empower a great number of black enterprises”.

Capital shift

But Mr Zim may find it difficult to meet these expectations. Anglo's subsidiaries are listed independently, so direct interference is tricky, though Mr Zim does have influence as a member of their boards. Some subsidiaries, including Kumba Resources, may announce this year deals to shift more capital to black investors. Mr Zim also wants more goods and services bought from black-owned suppliers. Last year business worth 5.7 billion rand ($1 billion) went to black firms. This should rise by at least a fifth each year. He wants more black managers: 40% of senior jobs should be held by non-white staff by 2009.

Satisfying other government demands will be more difficult. The government says firms should sell or transfer more equity to black investors, but measuring that is tricky. Anglo American wants recognition for unbundling itself a decade ago, when it helped to set up black mining firms such as African Rainbow Minerals and Mvelaphanda Resources. The government seems reluctant to recognise that. Officials also want the mining firms to set up firms to polish or cut stones, or to make jewellery. That would create jobs and could count as black empowerment. But miners say, reasonably, this is not their business and, anyway, South Africa's high labour costs mean it is not

the place to do it.

On his office wall hang two photos of Mr Zim smiling beside powerful people. In one he poses with Mr Trahar, in the other he sits next to Mr Mbeki. Keeping both men happy is going to be a delicate task.

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Clarification: Tecnovate eSolutions

Mar 3rd 2005
From The Economist print edition

We would like to make clear that the photograph of drug-smoking hippies and the caption “Lunch hour at the call centre” which accompanied our article “The call of the East” in the February 19th issue (print edition only) was not meant to imply anything about the behaviour of the employees of Tecnovate eSolutions. Sorry for any misunderstanding.

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Argentina's debt restructuring

A victory by default?

Mar 3rd 2005
From The Economist print edition

Alamy

The successful restructuring of Argentina's debts has set a painful new benchmark for creditors

Get article background

IN 1902, after Venezuela defaulted on its sovereign debt, German, British and Italian gunboats blockaded the country's ports until the government paid up. In 1881, after the Ottoman empire failed to honour its obligations, European powers simply seized Ottoman customs houses and helped themselves to their due. The options available to more than 500,000 aggrieved creditors of the Republic of Argentina, which defaulted on bonds worth $81 billion in December 2001, were more limited. After much bluff and bluster, a large majority of them meekly surrendered their claims before a deadline on February 25th, in exchange for new bonds worth roughly 35 cents on the dollar.

The giant debt swap is epic in scale. It involves 152 varieties of paper denominated in six currencies and governed by eight jurisdictions. These bonds will now be exchangeable for three new issues. More importantly, the swap carries important lessons for emerging-market creditors and debtors alike. Bondholder groups think it a travesty. But on March 1st, Néstor Kirchner, Argentina's president, declared the restructuring a triumph, claiming “at least 70-75%” of bondholders had accepted it. As *The Economist* went to press, detailed figures were still not available, though some reports suggested that the level of acceptances was even higher than Mr Kirchner's claim.

Even in a default, there is money to be made. So-called “vulture” funds pick over the non-performing bonds discarded by disheartened investors. In the summer of 2002, a few months after Argentina stopped honouring its debts, a brave buyer could have purchased a distressed bond in the secondary market for 20 cents on the dollar or less. On February 25th, he could have swapped it for crisp peso-denominated paper worth 35 to 37 cents: a tidy annualised return of 25% or more.

Not every vulture will settle for such quick pickings. The more patient among them will hold out for their full pound of flesh in the courts. They take their inspiration from Elliott Associates, an American hedge fund that spent $11.8m on distressed Peruvian debt and, after four years in the courts, forced the government to settle in 2000 for almost $56m. According to Manmohan Singh, an economist at the International Monetary Fund (IMF), the annualised returns from successful litigation can be more than 300%. Paradoxically, the higher the acceptance rate for a debt deal, the better for the refusniks: governments are more likely to settle with a small minority than with an army of litigants.

Elliott Associates did not seize Peruvian customs houses. Instead, it threatened to dip into the payments Peru made to other creditors through Euroclear, a settlements system based in Belgium. That legal avenue has since been closed, but other strategies will be tested, including a class-action lawsuit in New York. That said, litigants are likely to be more of a nuisance than a real threat to Argentina. “Vultures” is perhaps too grand a term for them. To a sovereign borrower, they are no more than mosquitoes who, as Mr Singh suggests, can draw enough blood to quadruple in size, but not enough to do real damage.

If litigation is more an irritant than a deterrent to sovereign defaulters, why should they ever repay anything? Several hard-pressed governments may be asking themselves the same question. “Restructuring was formerly a taboo word, now it's a topic of open conversation,” says Walter Molano, of BCP Securities. The “haircut” inflicted on bondholders—the proportion of debt that Mr Kirchner has successfully written off—sets a new standard. In other restructurings, creditors have had to accept either a cut in principal, a lengthening of maturity or a reduction in interest payments. Argentina has achieved all three.

Could Argentina afford to pay more? It managed a government budget surplus which, before interest payments, was around 4% of GDP last year, and its foreign-exchange reserves increased to more than $19 billion. With this money it could have sweetened its offer, perhaps by as much as 3 or 4 cents on the dollar, reckons Vladimir Werning of J.P. Morgan. But the government would have been unwise, he concedes, to do much more, committing itself to pay more in the future when it does not know how much money it will have.

Even after the swap, Argentina's debt will be more than $120 billion (see chart 1). Indeed, the 152 varieties of bonds eligible for the exchange amounted to just 55% of its total debt last year. It owes $13.8 billion to the IMF and another $15 billion to other multilateral institutions, such as the World Bank. During its economic crisis the federal government shouldered the debts of the provincial governments and stuffed the country's banks and pension funds full of bonds, called BODENs, which were then forcibly converted to pesos.

In the long run

At around 75% of GDP, Argentina's debt ratio remains

higher than the 52% carried by its neighbour Brazil. But the interest burden on Argentina's debts is now much lighter (a coupon of 2-5% in the first 10 years, compared with 10% in Brazil) and the maturities much longer than the market would normally accept. No big Latin American government has ever fully repaid a 30-year bond; Argentina has offered a 42-year bond.

Kirchner's swap shop 1

Argentina's public debt, $bn

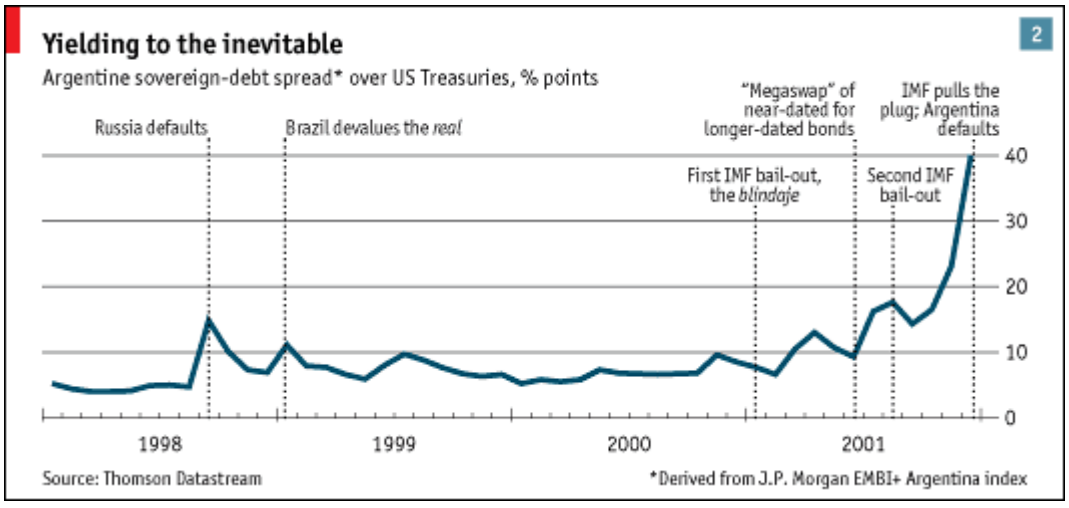
	Dec 2003*	Post-swap†
Bonds eligible for the swap	104.1	36.2
BODENs‡	18.5	19.4
Provincial guaranteed bonds	9.7	10.5
IMF loans	15.5	13.8
Other multilateral loans	16.7	15.1
Guaranteed loans	14.1	15.0
Other loans	7.6	7.6
Short-term debt	2.5	3.2
Total debt	**188.6**	**120.8**
Hold-outs	-	20.8

*Corrected for the effects of peso-ification
†Assuming 80% participation
‡Bonds compensating banks for peso-ification
Sources: AGM; Ministry of Economy; *The Economist*

Standard & Poor's, a credit rating agency, has said it will upgrade Argentina to B- after a successful debt swap, a rating shared by Ecuador, Suriname and Lebanon. Tax revenues are quite buoyant at present, but may sag when soya prices inevitably ebb and capacity constraints bite. The budget surpluses that Argentina requires are not too onerous at first, but sustaining them may be difficult. The country needs fiscal stamina, not budgetary heroics, if its debt ratio is to fall.

Argentina defaulted so heavily because it defaulted so late. Its descent into default, devaluation and destitution is vividly recounted in a new book by Paul Blustein (see article). Far from being too ready to flout its obligations, he concludes, Argentina was too reluctant to do so. Domingo Cavallo, a messianic politician who returned as finance minister in 2001, would not countenance default. “Who could conceive such a destructive idea for a country, and be bold enough to propose it?” he wrote in the Financial Times.

Mr Cavallo had made his name with his 1991 “convertibility” plan, which killed Argentina's chronic hyperinflation. The plan removed all scope for monetary mischief by pegging the peso to the dollar, and making the currencies freely interchangeable. But Argentina's “monetary self-denial”, as Mr Blustein calls it, coexisted uneasily with its financial self-indulgence. The Argentine government sold unprecedented amounts of bonds to foreign investors, accounting at its peak for more than a quarter of all emerging-market issuance. Its public debt increased from 35% of GDP at the end of 1994 to 64% at the end of 2001, nearly all of it denominated in dollars.



Russia's default in August 1998 deprived Argentina of such ready access to foreign capital (see chart 2). Then Brazil's devaluation five months later destroyed Argentina's competitiveness in foreign markets. The country was stuck with twin deficits, a trade gap and a budget gap, that foreigners were less and less willing to finance. To right itself, the Argentine economy needed to

regain competitiveness. Since the exchange rate could not fall, prices and wages had to instead. As recession took hold, peso prices edged downwards, tax revenues faltered and Argentina's dollar debts grew harder to repay.

With a weak hand, Argentina refused to fold, but kept raising the stakes. It took on a $15 billion loan from the IMF, known as the *blindaje* or “armour”, at the start of 2001 and a second $8 billion bail-out that summer. It completed its notorious “megaswap” of near-dated securities for longer-dated, higher-yielding bonds in June 2001, buying itself a little time.

Long before the event itself, it was clear that Argentina had to default on someone. As the last year of dollar-peso convertibility wore on, everyone jockeyed to make sure that someone would not be them. Gerardo della Paolera, of the American University of Paris, and Alan Taylor, of the University of California, have described the “fiscal war of attrition” that ensued*. Foreign investors moved their money out; the unions took to the streets, to forestall a raid on their pensions or a cut in their wages; the provincial governors kept up their spending, going so far as to issue their own scrip to fund it; eventually, depositors pulled their money out of the banks.

Bang, crash, wallop

In the end, Argentina defaulted on everyone. It stopped servicing its bonds, domestic and international; it cut wages and raided pension funds; it foisted its bad IOUs on to one side of the banks' balance sheets, then made a grab for the deposits on the other side, putting a freeze on withdrawals. It forcibly converted dollar deposits into pesos at one exchange rate; dollar loans at another. For the banks, this “asymmetric peso-ification” was every bit as painful as it sounds.

Must default be this messy? If the process were painless, governments would resort to it more often. Creditors would then be less willing to lend and bond finance would be more expensive. The sheer disorderliness of a default ensures that governments do not resort to it lightly.

A period of exile from capital markets is only the most obvious consequence of default. The legacy of financial disarray is more insidious. “Default”, write Carmen Reinhart, Kenneth Rogoff and Miguel Savastano—three current or former IMF economists—“can become a way of life.”** The more often default occurs, the less a defaulter has to lose, hence the more likely it will default again.

As a consequence, serial defaulters struggle to “tolerate” debt levels that other economies manage quite comfortably. Their credit rating begins to suffer even at relatively low levels of debt. The authors estimate Argentina's safe threshold of external debt at just 15% of GDP. Although a country's financial tendons may heal suspiciously quickly, they are permanently weakened each time they snap.

To default is natural

Andrew Haldane, of the Bank of England, and Mark Kruger, of the Bank of Canada, argue that “default is a natural feature of the market mechanism”†. Default and debt go together like risk and return. Argentine bonds offered higher yields than American Treasuries precisely because their promise to repay was not as secure. True, a more orderly system of payments standstills and debt workouts might marginally raise the incidence of default. But it would also raise the recovery rate for creditors. The two effects might cancel each other out. Default should be avoided at some cost, but not, they write, “at all costs”.

Reluctant to default, Argentina has been painfully slow to restructure its debts. Its standoff with creditors has been confrontational, drawn out and poisonous. When national governments go bust, there is no impartial bankruptcy court that can resolve their differences with creditors. But in previous defaults, the IMF has served as a close surrogate, note Nouriel Roubini and Brad Setser, authors of an admirably thorough book on debt restructuring††. In return for a loan, the Fund asks for a given amount of fiscal effort from its ward, which indirectly determines how much money the debtor can set aside for its creditors. The Fund, as its governors put it in an April 2000 communiqué, “should not micromanage the details” of a deal. But, some say, it should, nonetheless, offer its best guess of the country's ability to pay.

This time the Fund kept its guesses to itself. It did not set any fiscal targets for Argentina beyond 2004 and ventured no opinion on Argentina's capacity to repay its debts. Messrs Roubini and Setser accuse the Fund and its major shareholders in the capitals of the rich world of coming close to abdicating their traditional roles.

AFP

The barber of Buenos Aires

If the Fund has remained remarkably hands-off, it is perhaps because its hands are not entirely clean. After twice lending money to Argentina in 2001, the IMF is now itself one of the country's biggest creditors, anxious to be repaid. In September 2003, it agreed to a new programme, which, in effect, rolls over the billions Argentina still owes as they come due. This should have helped it chivvy Argentina towards a deal. But Mr Kirchner was in no mood to be chivvied. First, he threatened to default on the Fund. Then last summer, he suspended the September 2003 agreement, deciding that the IMF's money was not worth the accompanying hen-pecking.

In such situations, the Fund is only as strong as its major shareholders want it to be. Having sided against the Fund in its quarrels with Mr Kirchner in 2003, the American government's stance will again be crucial in the months ahead. The IMF must decide whether to give its blessing to the debt exchange, and what to demand of Argentina in return for rolling over its debts, $5.5 billion of which falls due this year. To call the Fund a pawn of the American Treasury is “an exaggeration,” says Mr Blustein, “but not an inordinate one.”

How quickly will investors shrug off this encounter with emerging-market risk? Many already have. Gross bond sales are strong, and the premium over American Treasuries of J.P. Morgan's index of emerging-market bonds (the EMBI Global) is just 3.35%—around a ten-year low.

Indeed, capital markets appear to have a remarkably short memory. Argentina has defaulted on its foreign debts five times in the past 175 years; Brazil seven times; and Venezuela nine times. A debtor can default no more than once, unless a creditor is willing to forgive and forget. Amnesia sometimes sets in remarkably quickly. The bad loans that Argentina inherited from the debt crisis of the 1980s were written down in 1992. Just three years later, Argentina was carrying more foreign debt, both in absolute terms and relative to the size of its GDP, than it had in 1991.

J.P. Morgan has announced that Argentina's weight in the EMBI Global will rise from 1.9% to about 2.7% once the latest debt swap is declared a success. The index weights countries according to how much debt they have issued. Thus any fund manager tracking the index must, in effect, lend more to the countries borrowing the most. In the heady days before its default, when Argentina accounted for 23.3% of the index on average, the perversity of this incentive was manifest. Purists will protest that bond prices, like all prices, are set at the margin. As long as the

marginal investor is willing to bet against the index, prices will not be distorted. But such brave investors may be in short supply.

Against the grain

Mohamed El-Erian, an emerging-market specialist at PIMCO, an American fund manager, is one. He quietly eased his firm's money out of Argentina a year before the default. Cleaving tight to the index, he says, is about “personal risk management”, not asset risk management. In other words, a fund manager who does badly when the index falters is unlikely to lose his job. Departing from the index and then underperforming is a sure way to get fired. This is why so few other managers walked away from Argentina earlier.

With real interest rates still so meagre in mature markets, investors are chasing yield even into territories they formerly scorned. But emerging markets remain chronically vulnerable to sudden drop-offs in capital flows. Last spring, for example, when the markets realised American interest rates were about to turn, a yearlong rally in emerging-market bonds was undone in a matter of weeks.

In theory, capital should flow from where it is abundant to where it is scarce. But Argentina's downfall demonstrates the dangers of relying too much on this dynamic. In the 1990s, Argentina tried to borrow its way back to the *belle époque* it enjoyed prior to 1914, when decades of foreign investment, anchored by a rigid monetary standard, built the railways and boulevards that still distinguish the country from its neighbours in the minds of its citizens. The embrace of the international bond markets in the 1990s lulled Argentina into thinking it had left the periphery of global capitalism and joined its centre.

Other developing countries appear under no such illusions. For all the fear that Argentina's default may have set a precedent, many of its peers seem to have drawn the opposite lesson from this sorry saga. In recent years emerging-market countries as a whole have been net exporters of capital. They have offset generous private inflows with the prudent accumulation of foreign reserves. With these war chests at their disposal, countries can insure themselves against the sudden reversals of market sentiment to which they are still vulnerable. Emerging markets may enjoy the benefit of recurrent exuberance; they never get the benefit of the doubt.

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*Gaucho banking redux. NBER working paper 9457

**Debt intolerance. NBER working paper 9908

†Bank of Canada Review, Winter 2001-2002

††Bailouts or Bail-ins? IIE, 2004

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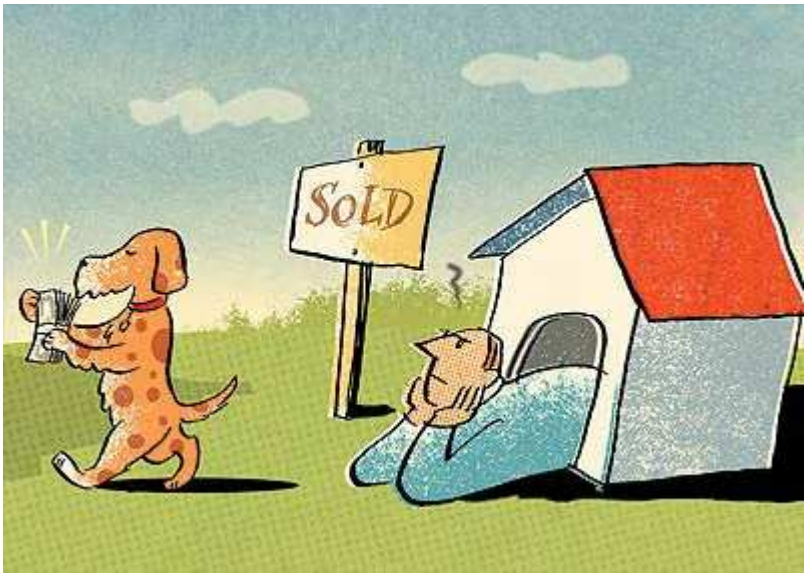
Global house prices

Still want to buy?

Mar 3rd 2005
From The Economist print edition



According to our latest house-price indicators, it is now much cheaper to rent than to buy a house in many countries

The Economist's house-price indices

% change

	on a year earlier		
	Q4 2004*	Q4 2003	1997-2004
South Africa	29.6	23.4	195
Hong Kong	28.7	-1.1	-52
Spain	17.2	16.5	131
France	16.0	12.7	90
New Zealand	13.5	24.8	52
United States	11.2	8.2	65
China	10.8	5.1	na
Britain	10.2	15.6	147
Sweden	9.8	6.1	76
Italy	9.7	10.6	65
Belgium	9.3	8.2	60
Ireland	8.5	13.7	179
Denmark	7.3	3.4	50
Canada	6.2	6.9	41
Netherlands	2.8	3.4	75
Australia	2.7	18.9	113
Switzerland	2.3	2.4	11
Singapore	0.9	-2.0	na
Germany	-1.3	-1.7	nil
Japan	-6.0	-5.7	-25

*Or latest

Sources: ABSA; Bulwien; ESRI; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; government offices

WHEN *The Economist* launched its global house-price indicators in 2002, residential-property markets were merely warming up. Today they are red hot in many of the 20 countries we cover: in half of them, prices have risen by around 10% or more in the past year (see table). But for the first time since we started to track them, housing markets in several countries have slowed sharply.

The most dramatic slowdown has been in Australia where, according to official figures, the 12-month rate of increase in house prices fell to only 2.7% in the fourth quarter of last year, down from nearly 19% at the end of 2003. Another index, calculated by the Commonwealth Bank of Australia, which is based on prices when contracts are signed rather than at settlement, shows that average house prices fell by 7% in the year to December; prices in Sydney plunged by 16%. The Reserve Bank of Australia's quarter-point increase in interest rates this week is likely to give prices another downward nudge.

Britain's housing market has also cooled since last summer. The Nationwide index, which we use, was still up by 10% in the year to February, down from 20% growth in July. Other anecdotal evidence suggests that prices have fallen since last summer in many parts of the country.

In contrast, America's housing bubble continues to inflate. Although the rate of increase slowed in the fourth quarter, prices were still up by 11.2% over the year. In California and Washington, DC, housing prices rose by more than 20%. Alan Greenspan, the Fed's chairman, recently admitted in congressional testimony that there may be property bubbles in “certain areas” and a risk that prices could decline. There is certainly evidence that prices are being driven by speculative

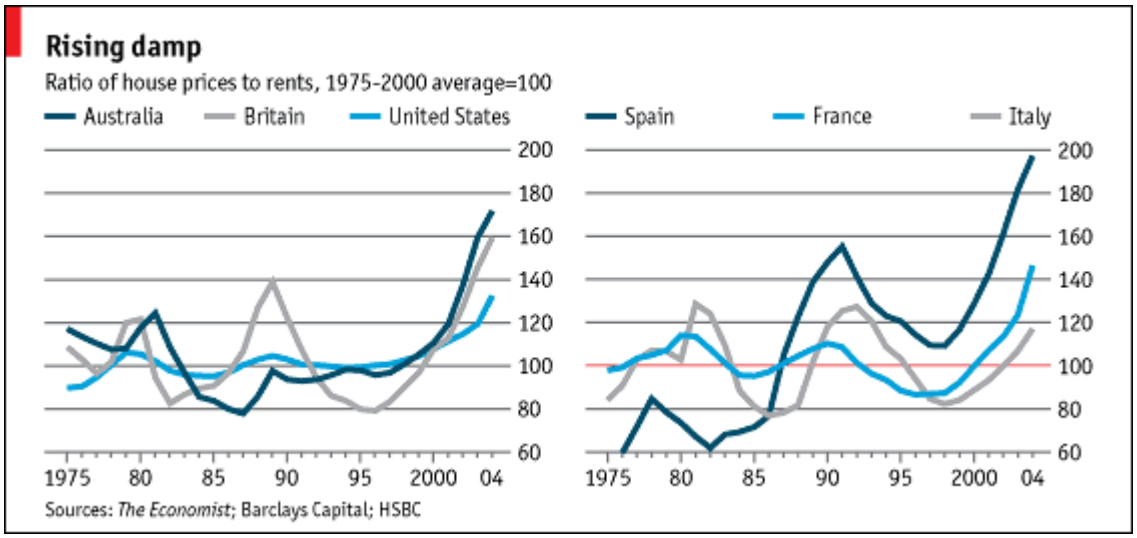
demand: a new study by the National Association of Realtors shows that one-quarter of all houses bought in 2004 were for investment, not owner-occupation.

House prices are still rising rapidly in continental Europe. French house-price inflation has accelerated to 16%, its fastest on record in real terms and only a whisker behind Spain's 17%. Prices in Italy, Sweden and Belgium are also rising at close to 10%. Excluding Germany, where prices fell again in 2004, average home prices in the euro area have risen by 12.5% over the past year, causing some concern at the European Central Bank.

Punishing prices, puny yields

The main reason why housing markets have cooled in Australia and Britain is that first-time buyers have been priced out and demand from buy-to-let investors has slumped. While house prices have soared, rents have risen modestly or even fallen in some cities. In America, Britain, Spain New Zealand and Australia, average net rental yields (allowing for management fees, maintenance and empty periods) have fallen to 3.5% or less, well below mortgage rates. Shane Oliver, the chief economist at AMP Capital Investors, estimates that net rental yields on houses in Sydney are only 1%. Landlords are nowhere near covering their true costs, but many still hope to make their profit from capital gains. That sounds ominously similar to the days of the dotcom bubble, when it was argued that the link between share prices and profits no longer mattered.

According to calculations by *The Economist* (with the help of Julian Callow of Barclays Capital), house prices are at record levels in relation to rents (ie, yields are at record lows) in America, Britain, Australia, New Zealand, France, Spain, the Netherlands, Ireland and Belgium. America's ratio of prices to rents is 32% above its average level during 1975-2000. By the same gauge, property is “overvalued” by 60% or more in Britain, Australia and Spain, and by 46% in France (see chart).



The ratio of prices to rents is a sort of price/earnings ratio for the housing market. Just as the price of a share should equal the discounted present value of future dividends, so the price of a house should reflect the future benefits of ownership, either as rental income for an investor or the rent saved by an owner-occupier. To bring the ratio of prices to rents back to equilibrium, either rents must rise sharply or prices must fall. Yet central banks cannot allow rents to surge as this would feed into inflation. Rents directly or indirectly account for 29% of America's consumer-price index, so rising inflation would force the Fed to raise interest rates more swiftly, which could

trigger a fall in house prices. Alternatively, if rents continue to rise at their current annual pace of 2.5%, house prices would need to remain flat for over ten years to bring America's ratio of house prices to rents back to its long-term norm. There is a clear risk prices might fall.

Lower real interest rates might justify a higher p/e ratio. For example, real interest rates in Ireland and Spain were reduced significantly when these countries joined Europe's single currency—though not by enough to explain the whole rise in house prices. In Britain, where tax relief on interest payments has been scrapped, real after-tax rates are close to their average over the past 30 years, and so do not justify a higher price/rent ratio. In America, too, real post-tax interest rates are not historically low, in part because mortgage-interest tax relief is worth less at lower rates of inflation. For instance, if interest rates are 10%, tax relief is 30% and inflation is 7%, the real after-tax interest rate is 0%. If interest rates are 6% and inflation is 3% (ie, the same gap as before), and tax rates stays the same, the real interest rate is 1.2%.

The unusual divergence between house prices and rents does not just affect investors; it also undermines the conventional wisdom that it is always better to buy a house, because “rent is money down the drain”. Today in many countries it is much cheaper to rent than to buy.

Rent asunder

Take a two-bedroom flat in London, which you could buy for £450,000 ($865,000). To rent the same flat would currently cost £1,700 a month. In addition to a 6% mortgage rate, a buyer would face annual maintenance and insurance costs of, say, 1.25%. In the first year, the rent of £20,400 compares with total mortgage interest and maintenance payments of £33,000, a saving of £12,600. Interest payments would be less if a large deposit were paid, but in that case the income lost from not investing that money elsewhere has to be taken into account.

Assume that rents rise by 3% a year, in line with wages, while house prices from now on rise in line with inflation of 2%. At the end of seven years (the average time before the typical homeowner moves), you would be almost £35,000 better off renting, taking account of the capital appreciation and buying and selling costs. In other words, even without a fall in real house prices—which many believe to be likely—buying a house in Britain today seems a poor investment.

The figures look even more striking in the San Francisco Bay Area, where it is possible to rent an $800,000 house for $2,000 a month. Making the same assumptions about rents and house prices, but also deducting tax relief on a fixed-rate mortgage and adding property taxes, a buyer would pay $120,000 more over seven years than if he had rented. House prices in San Francisco would need to rise by at least 4% a year (2% in real terms) for it to prove cheaper to buy a house. Since 1950 American house prices in real terms have risen by an annual average of just over 1%. To expect them to rise faster from their current dizzy heights smacks of irrational exuberance, to say the least.

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J.P. Morgan and private equity

Money spinning

Mar 3rd 2005 | NEW YORK
From The Economist print edition

The largest bank-owned private-equity fund shrugs off its parent

AMERICA'S second-biggest bank is in transition this year. At J.P. Morgan Chase, expenses are being cut, management is being reshuffled, and businesses reorganised. The most striking change so far came on March 1st, when the bank said it was spinning off J.P. Morgan Partners, its large private-equity arm, to its managers.

Getting rid of the private-equity business, successful though it has been, solves a few problems. As the money it manages has swollen, to more than $13 billion, J.P. Morgan Chase has found itself in the uncomfortable position of competing against its clients in auctions for companies. And because the private-equity arm recently started accepting outside investors into its funds, it faces additional conflicts of interest when hiring Morgan's own bankers to provide services such as debt and equity underwriting. Last year, the bank became a huge force in the market for initial public offerings, largely by taking its own companies public. Co-investors in its private-equity funds might wonder whether a contest for such services would be better value, even if it meant less money for the bank. The bank is keeping a smaller private-equity business with no outside investors, managing $2.5 billion, that it acquired when it bought Bank One last year.

Morgan has long been unhappy about how the stockmarket has valued its forays into private equity. In the late 1990s, investors were unimpressed by huge gains, dismissing them as unsustainable. During the market bust of 2001-03, the volatility of private-equity earnings was thought to increase the variability of the bank's results. Morgan now wants to limit its exposure to 10% of its capital base, down from the 15% of the recent past.

Such a limit, Morgan says, is a real hindrance for such a fast-growing business. The private-equity arm's first investment, made just over 20 years ago, was a mere $4m, spent on a bunch of mid-western television stations. In the past few months alone, Morgan was able to commit almost $700m to take part in three acquisitions, in cinemas, drugs and chemicals, worth $6 billion. Past successes include investments in Jet Blue, a budget airline, and Home Depot, a chain of hardware stores.

The bank will retain its own investments in the private-equity fund managed the group. These amount to $5 billion. It will also chip in up to $1 billion to the group's next fund, giving it a share of up to 24.9%. This fund is likely to be raised next year, when the separation of the bank from its private-equity arm is completed.

The existing management of the private-equity arm will continue as a partnership: those who know the investments already, runs the argument, are best placed to extract the most value from them. This should also put the bank, thanks to personal ties, in a good position to supply ancillary services to the fund (managing share offerings and so forth) without having to worry about conflicts of interest.

The merits of these arguments, however, are open to question. If the managers of the private-equity arm were truly independent of Morgan, the link with the bank should loosen quite fast. And although the current managers of the private-equity arm may be best placed to maximise the value of the current portfolio, they seem to have got a better deal than the bank. They will own an excellent business with a fine record and loads of assets, and can expect generous fees. What are Morgan's shareholders getting? Nothing directly: this is not a sale, but a spin-off. They will see their investments well managed, no doubt, but can expect less from supplying ancillary services and are giving up a good business, run by managers who clearly know a good deal when they see one. This week's may be the best of the lot.

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The World Bank succession

Looking around

Mar 3rd 2005 | WASHINGTON, DC
From The Economist print edition

The Bush administration casts a wide net for a new World Bank boss

AFP

Count on Carly?

PAUL WOLFOWITZ and Carly Fiorina have little in common. One is America's craggy deputy defence secretary, best known as the top neo-con in the Bush administration. The other is a telegenic but fallen corporate titan, recently ousted as chief executive of Hewlett-Packard (HP). This week both were tipped, within hours of one another, to be on George Bush's short-list for appointment as president of the World Bank. Mr Wolfowitz quickly killed the idea. But Ms Fiorina is under consideration. Is the White House thinking creatively, or getting desperate?

The World Bank's boss has traditionally been an American (the Europeans choose the head of the IMF). James Wolfensohn, the current president, has run the place since 1995. He announced in January that he would step down when his second five-year term expires at the end of May. Early speculation about a successor centred on Robert Zoellick, Mr Bush's former trade representative, who was known to be keen on the post. But in January Mr Zoellick was asked to move to the State Department, to become Condoleezza Rice's deputy.

That left several plausible, but underwhelming, candidates, including Randall Tobias, head of Mr Bush's AIDS programme, John Taylor, the top international man at the Treasury Department, and Peter McPherson, a former head of *USAID*, America's bilateral aid agency, and Mr Bush's point man on rebuilding Iraq's economy. Even before Mr Wolfowitz and Ms Fiorina were mentioned, the White House's delay in announcing a decision had suggested it was looking further afield. Publicly the Bush administration has said only that it will suggest a name before Mr Wolfensohn steps down.

Mr Bush's choice matters. The president of the World Bank is enormously important in the development business, and the Bush administration has a clear agenda for the Bank (more debt forgiveness, more grants and less lending). This is to say nothing of its broader foreign-policy goals. The choice will say a lot about where America sees the Bank heading.

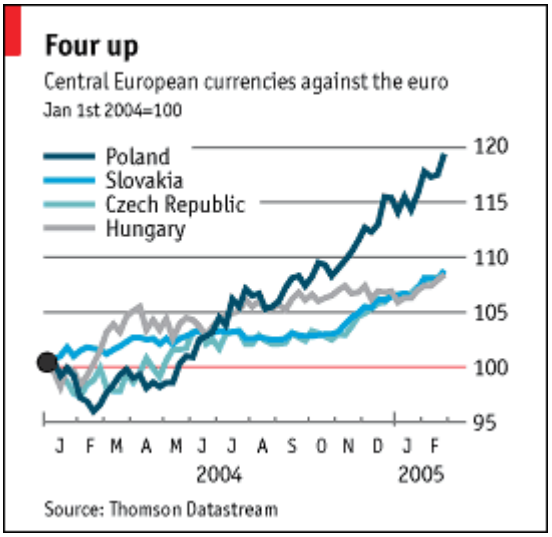
So what might Ms Fiorina imply? She has no real experience in development and, save for a stint advising Arnold Schwarzenegger, little in politics. Her marketing talents would be useful: largely, the World Bank job is a bully pulpit. But her record at HP calls into question her ability to run a sprawling institution. HP's merger with Compaq seemed flawed from the start, and HP's share price fell during her tenure. That need not rule her out. Ms Fiorina's reputation at HP was not unlike Mr Wolfensohn's at the Bank: a leader with a big vision who could not manage. Who knows? Maybe Ms Fiorina would push through a merger with the IMF.

Central European currencies

Too strong for comfort

Mar 3rd 2005 | WARSAW
From The Economist print edition

A headache for a region's central bankers



THESE are heady days for central Europe's currencies, and awkward ones for their central banks. Lately, the monetary authorities in Slovakia, which has become an unlikely exemplar of democracy (see article) and economic reform, have been the region's busiest. The koruna has risen by 9% against the euro since the start of 2004, causing the central bank to intervene furiously in a bid to hold the currency down. So far, it has failed, despite a cut of a percentage point in interest rates on February 28th.

Other central European currencies have been sprightly too (see chart). The Polish zloty gained 15% against the euro (and 25% against the dollar) last year, and has kept rising this year, prompting the central bank to shift its policy stance to “easing” last week. The Hungarian forint, which moves in a band either side of a central rate against the euro, is trading within a whisker of its upper limit, even after a cut of three-quarters of a point on February 21st. In the Czech Republic, a surging koruna has forced the central bank to reverse its policy of tightening: rates were trimmed by a quarter-point in January, to 2.25%, a shade higher than the euro area's.

The main reason for the currencies' strength is a flood of short-term capital inflows, attracted partly by the promise of convergence with the euro zone, but also pushed by low interest rates there: David Lubin, an economist at HSBC, points out that for the first time in 20 years, real euro-area interest rates have been negative. In Hungary, despite recent cuts totalling four and a quarter percentage points, short-term rates are still 8.25%; government bond yields are fat enough to pull in money borrowed cheaply elsewhere. Poland is more attractive still, lacking Hungary's wide current-account deficit.

None of this is much fun, however, for the region's central banks. On the one hand, strong currencies have helped curb inflation, allowing (or even necessitating) easier monetary policy. On the other, they threaten to choke off exports to the euro area, central Europe's main market. And central bankers are wary of cutting rates when governments are doing too little to rein in budget deficits, which are at least a point or two above the 3% of GDP supposedly needed to qualify for the euro, and economic growth is buoyant.

For the time being, central banks seem more worried about the adverse effects of strong currencies than about the risks of lower interest rates. Just possibly, they may soon have the opposite problem. Some members of the Polish central bank's rate-setting council fear the zloty may be heading for a fall, with two national elections and a referendum on the European Union's constitution due this year. The forint could be even more vulnerable, because its main prop is Hungary's still-high interest rates, investors' reward for disregarding the country's chronic fiscal problems. If rates fall much further, investors could head out of the forint as fast as they rushed in.

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America's Community Reinvestment Act

Time for a rethink

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The rules requiring banks to serve low-income areas are changing

BANKS, perhaps even more than other businesses, are almost certain to be keener on serving the rich than the poor. In America, however, the law makes them curb their instinct a little. Since the Community Reinvestment Act (CRA) was passed by Congress in 1977, federally insured banks and savings institutions have been obliged to meet the "credit needs" of low-income areas in the communities they serve. Now change is in the air. On February 25th the Federal Reserve became the last of America's four national bank regulators to propose relaxing the act's rules.

Under the CRA, banks with assets of more than $250m must show that they serve poorer communities adequately. They are tested on three grounds: lending, bank services and "community investments"—anything from soft loans for cheap housing to equity investment in small businesses. Small banks are tested mostly on lending and have looser reporting requirements.

The bank regulators are obliged to scrutinise the CRA every few years, and are now nearing the end of an examination they began in 2001. They all agree it is out of date. When the act was passed, banking was a local business, in part because of restrictions on interstate banking and even on branching within states. So the CRA's definition of a bank's community—essentially, where it has branches—made sense. Now, internet banks and mortgage firms offer credit anywhere; consolidation has spawned banks with customers (but not necessarily branches) across the country; and non-banks, such as credit unions and mortgage companies, which are not subject to the act, vie with banks to offer loans. "The concept of localised banking is fundamentally changing," says John Hawke, a former Comptroller of the Currency, one of the national regulators.

The regulators are free to change some of the rules themselves. Last year the Office of Thrift Supervision (OTS), impatient with the slow pace of reform, unilaterally relaxed the rules for the banks it oversees. That prompted the other three—the Fed, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC)—to speed up their own reviews.

The changes proposed by the Fed are identical to those put forward earlier in February by the OCC and the FDIC, and similar to the OTS's. They would raise the threshold defining big banks for the purposes of the act from $250m to $1 billion and create a middle tier of banks with assets between these limits. These banks, like the smallest, would be exempt from many reporting requirements as well as from the rigid three-part test. Regulators would scrutinise their investment and services activities—but allow banks more flexibility to decide whether or not these activities made any sense. The OTS, however, said on February 28th that it will scrap the three-part test even for big banks. The proposals of the Fed, the OCC and the FDIC are now open to public comment.

According to the FDIC, at the end of last year 1,484 banks, with total assets of $584 billion, overseen by itself, the Fed or the OCC would have qualified for the new middle tier and thus be exempt from the three-part test. Critics see the looser rules as the first stage in the gutting of the CRA. “We are on our way to bifurcating access to capital in America,” says John Taylor of the National Community Reinvestment Coalition, a community-development group. Critics also fear that it will be hard to hold smaller banks to account without data on how and to whom they lend. Given the chance to invest less in their communities, they say, banks will do just that.

The smaller banks retort that documentation is too burdensome and that good community lending and investment opportunities are scarce, given competition from bigger lenders. Scott Zimbrick of Citizens Bank, an Oregon bank with $330m in assets, says that in three years of searching for a sound community-investment opportunity he managed to land only one, because of competition from “bigger banks with deeper pockets, more expertise and huge CRA departments.”

Both large and small banks grumble that the rules are too fiddly. Bankers can gain credit for the service test if they sit on the boards of non-profit organisations—but only if they are on the finance committee. One banker grouses that a small-business loan is defined as any loan to a company of $1m or less. “Are we not helping poorer communities attract jobs by lending a company there $1.5m?”

Most bankers claim they would do the bulk of what the act requires—mortgages and small-business lending—anyway, because it is profitable. “They are no different, in terms of profitability and standards, than our similar, non-CRA products,” says Doug Woodruff of Bank of America. No wonder that some believe a more thorough re-think of the CRA, not just an easing of reporting requirements, is needed.

Mark Willis, head of J.P. Morgan Chase's community-development group, believes the CRA has been “extremely” important so far and that in the future, the real “bang for the buck in our communities” will come with community-development investments and services, which tend to require more innovation and technical assistance than “mainstream” lending and mortgages. His bank has promised $35 billion for such projects (out of $800 billion in total CRA commitments) over ten years. Activists applaud, but doubt that other banks will look beyond lending if the rules are relaxed.

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Economics focus

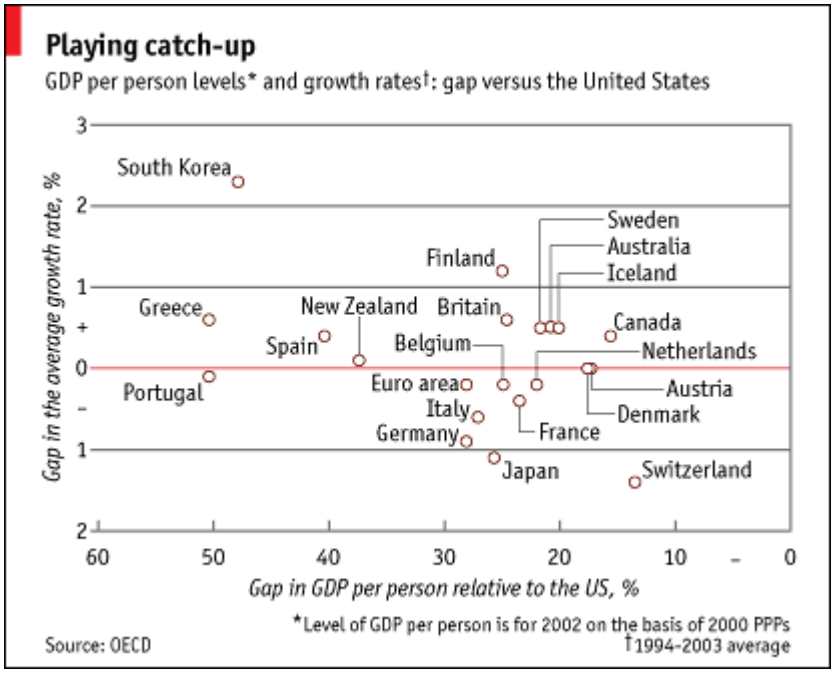
Old before their time

Mar 3rd 2005
From The Economist print edition

Labour-market reform remains the key to higher living standards

IN MANY European countries, calls for economic reform are heard more often than they are heeded. However, a new report by the OECD, "Economic Policy Reforms in OECD Countries: Going for Growth", deserves attention. It may aid reform by providing more detailed advice and better measures of relative economic performance.

That is timely, because the need for economic reform is pressing. In the post-war years to the 1980s, the world's richest economies were mostly converging towards similar levels of income per person. During the 1990s, however, that convergence came to a halt. Nowadays, income per person in the euro area is around 30% less than in America (see chart). And average growth rates in the euro area lagged behind America's in the ten years to 2003. If that continues, as it did last year, the gap in living standards will continue to widen.



To understand how European countries might close the gap, the report examines two contributing factors. The first is productivity, defined as output per hour of labour. The second is how much labour is employed.

Some European economies score well on the first measure. The average French worker is more

productive than his American counterpart; the average German worker, slightly less. Partly, however, good productivity figures are a reflection of the greater proportion of Europeans, especially those with few skills, who are either unemployed or not seeking work. Worse still, most of Europe has lower productivity than America.

Fortunately, the news is cautiously optimistic on the first front: productivity gains are being made thanks to product market reforms which, by fostering competition, have been shown to boost labour productivity. Measuring the progress in these reforms is tricky, however, since they involve thousands of regulations. For example, how is it best to compare a reduction in start-up costs with, say, a lowering of state control? The OECD has created a summary indicator of product-market regulation, assigning thousands of weights to different reforms, so that no single type of measure is favoured. On these measures, regulations have eased in all European Union countries since 1998. Happily, countries that regulated the most seven years ago have been the most active in deregulating.

Can further product-market reforms alone close the gap between America and Europe? Almost certainly not. Increasing the supply of labour matters just as much. Germany has recently made a welcome start by cutting jobless benefits and encouraging the long-term unemployed to seek work, but in Germany, as in other countries, there is still far to go.

The OECD pays particular attention to the low participation rates of women and old people in the labour market. In America, 70% of women are in work or looking for it; in the 15 members of the EU before last year's enlargement, only 61% were. Only one in ten EU couples with small children said that they prefer to rely on a male breadwinner for their income, yet four in ten lived that way. One explanation is that the incomes of second earners, who are usually women, are taxed at a much higher rate than the main earner. In Germany, spouses of people on the average production worker's wage must pay 53 cents in tax out of the first euro they earn.

An army in slippers

But the withdrawal of old people—or even those in late middle age—from the labour market is perhaps the biggest single cause of the participation gap. In America, 62% of those aged 55-64 have a job or are looking for one; in the EU the figure is only 45% (and sinks to 32% in Italy and 29% in Belgium, although Nordic countries score better). Some may chalk this up to a cultural preference for early retirement. If Europeans want to retire in middle age to a bungalow by the sea, the argument goes, why force them to work instead?

But government rules matter as much as tastes. Generous European pension and early-retirement schemes, along with disability and unemployment programmes, can make work especially unattractive for old people. Low minimum retirement ages have the same effect. Other benefit schemes, with complex rules, can also encourage people to stay out of paid employment. Indeed, past policies were partially intended to encourage people to retire early, to create “room” for younger workers.

The OECD has attempted to measure the implicit “tax” on working for someone nearing retirement age. This tax measures the pension and other benefits that old people forgo when they continue to work, expressed as a proportion of their wage. A common problem is that pension benefits cannot be deferred in their entirety in many countries. If you keep working, some benefits are lost altogether and cannot be collected later.

For 55-year-olds in Germany or France, this implicit tax amounts to 50% of the average wage for people in that group. For 60-year-old Dutch people, the loss of benefits is 90% of the wage; Belgians face an effective tax rate of 80%. Faced with such arithmetic, why should older people

bother to work?

The OECD estimated what would happen if pensions no longer encouraged early retirement—suppose, say, that pensions guaranteed a fixed pot of money: less each year if you retire early, but more if you stay at work. It found that many Belgians, for instance, would work as late in life as people in Scandinavia and America. This supports the idea that old people today are responding more to incentives and less to a preference for leisure.

But who can say for sure? If the EU does reduce the obstacles to work, many Europeans might still choose to toil less than Americans. But that would be an entirely different matter—a choice made freely, rather than in response to powerful government-supported incentives.

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Science in the former Soviet Union

Star Wars into ploughshares

Mar 3rd 2005 | SAN FRANCISCO
From The Economist print edition

America's attempt to find peaceful employment for the Soviet Union's weapons scientists seems to be working

WANT to meet a nuclear physicist on your next trip to Moscow? Try hailing a cab. Since the collapse of the Soviet Union, and of that country's extensive arms programmes with it, weapons scientists of all kinds have had trouble finding work. Taxi driving is one option for making ends meet. Another, of course, is to work with a government or terrorist organisation that would like to have the Bomb, some unpleasant bacilli, or some other weapon of mass destruction (WMD). That is why, some years ago, the American government decided to provide a third option—to work, under American sponsorship, on peaceful projects that would allow an expert to use his expertise for commercial gain.

A report to be published in the next edition of *International Security* suggests that the experiment is working. The report's authors employed a Russian survey firm to interview 600 local scientists whose experience might be turned to weapons making in such places as North Korea, Iran or Syria. The survey was not so crass as to ask the direct question, “would you help these countries develop nuclear or biological weapons.” It merely asked if they would be willing to work in one of them.

The result was that researchers backed by western money were half as likely as their unfunded counterparts to consider such employment possibilities. Of course, they might just be attracted by the local nightlife. But as Deborah Yarsike Ball, one of the report's authors, observes, “North Korea

is certainly not one of the world's vacation hot spots.” Dr Ball works on the Proliferation and Terrorism Prevention Programme at Lawrence Livermore National Laboratory in California, one of America's atomic-weapons labs.

Weapons of mass construction

The Civilian Research and Development Foundation (CRDF) in Arlington, Virginia, which celebrates its tenth anniversary this year, is one of the oldest programmes designed to tap the energies of ex-Soviet scientists. It has a budget of $21m, about two-thirds of which comes from the taxpayer, under various guises, and the rest from contracts and private funds. It uses this money to finance a combination of grants and training that help its clients to do two things. The first is to switch to fields of research with commercial potential. The second is to learn how to identify and court commercial partners, so that the fruits of their new research may be brought to market. For, as Kirill Dmitriev, the managing director of Moscow's Delta Private Equity Partners, puts it, “Russia doesn't know how to market and package products to outside markets.”

Craig Smith, a researcher at Lawrence Livermore who is currently on loan to the Naval Postgraduate School in Monterey, California, has been helping Ukrainian researchers from the cryptically named Institute for Single Crystals to create explosive-detection technology for use in places such as luggage and shipping containers. Their previous job was building missiles. But, assisted by a CRDF grant, they are advancing quickly with product development, and Dr Smith is now trying to put them in touch with potential commercial partners.

Another CRDF-sponsored partnership is the one between SciClone Pharmaceuticals, of San Mateo, California, and Verta, a St Petersburg-based firm that employs two dozen former biological-weapons scientists from Russia's State Research Institute of Highly Pure Biopreparations. Before the CRDF introduced it to Verta, SciClone was working on an injectible compound designed to stimulate the immune system and fend off infection. Verta's researchers had an alternative compound that can be taken by mouth. With help from CRDF grants, Verta's researchers are collaborating with SciClone to develop oral treatments for tuberculosis, hepatitis C and other diseases that are accompanied by suppression of the immune system.

As Alexander Kolobov, Verta's director, puts it, “I am sure that we could perform the same TB research without CRDF's help, but it would take much more time and would be carried out on a lower level.” SciClone is happy, too. Verta's researchers continue to live in Russia, and although they are well paid by Russian standards (which is, after all, the point of the exercise), they are a lot cheaper than they would be if they lived in America. According to Cynthia Tuthill, SciClone's vice-president of scientific affairs, “We were able to get clinical data for a fraction of what it costs in the United States.”

CRDF has a long list of such collaborations. Scientists from the Eliava Institute of Bacteriophage, Microbiology and Virology in Tbilisi, Georgia, are working with a team from the Battelle Memorial Institute in Columbus, Ohio, on a new method to identify anthrax rapidly in the event of a bio-terrorist attack. The Institute of Physiologically Active Compounds, in Chernogolovka, Russia, is co-operating with the University of Michigan in Ann Arbor on a device for measuring neurotoxic agents in the blood. This will allow the rapid detection of exposure to chemical-warfare agents. And besides encouraging enterprise, CRDF's grants also encourage scientists to stay put, helping to build self-sufficient scientific communities. Nana Voitenko, who leads a team of diabetes researchers at the Bogomoletz Institute of Physiology, in Kiev, was training to be a weapons scientist at the Moscow Institute of Physics and Technology when the Union collapsed. In 1997 she gave up her pitiful Ukrainian salary and moved to Iowa State University, in Ames, to work as a researcher until her first CRDF grant came through. It was that grant which enabled her to return home and start her team.

The temptation to leave for more profitable pastures can, however, be powerful. Once, Dr Smith recounts, the deputy director of a Ukrainian laboratory went missing for several days. Fearing bad news, he called the scientist's home. The scientist's wife explained that her husband was busy harvesting potatoes, in preparation for the lean winter months. As Dr Ball's paper concludes, “western assistance programmes work to reduce the threat of WMD brain drain. But their task is not complete. Now is not the time to pull back.” If a potato harvest can still tempt a weapons scientist from his laboratory bench, that sounds like wise advice.

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Homo floresiensis

The lady returns

Mar 3rd 2005
From The Economist print edition

The latest on Florence

DOUBTS about the nature of *Homo floresiensis*, the diminutive species of fossil hominid discovered last year on the Indonesian island of Flores, have been dispelled by modern technology. Teuku Jacob, an Indonesian palaeontologist not involved in the original discovery, had suggested that what has been found is actually a group of congenitally deformed *Homo sapiens*, and not a new species at all. (Dr Jacob caused controversy last December when he spirited the fossil bones away from the Indonesian Centre for Archaeology in Jakarta, where they were deposited, against the objections of most of the team that found them. On February 23rd, though, he brought them back.)

A paper published in this week's *Science* by Dean Falk, of Florida State University in Tallahassee, and her colleagues, shows that Dr Jacob's theory of Florence's origin is wrong. The team demonstrated this by looking at the anatomy of her brain. Obviously, the soft tissue decayed long ago, and the skull itself is too precious to cut open. Instead, they made a “virtual” endocast of Florence's skull (in other words a three-dimensional map of the space where the brain used to be) using computerised tomography—a technique more commonly applied to living tissue.

Florence's brain turns out to be similar in its pattern of lobes to that of *Homo erectus*, a species already known from Indonesia, and quite unlike that of *Homo sapiens* including the smaller than average brains of central-African pygmies. *Homo floresiensis*, as most researchers other than Dr Jacob had always suspected, seems to be a locally evolved descendant of *Homo erectus*. Now she and her fellow fossils are back home, the investigation can continue.

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Economist.com SCIENCE & TECHNOLOGY
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Treating depression

Deep impact

Mar 3rd 2005
From The Economist print edition

A way of switching depression off

ROB MATTE, a 38-year-old Canadian laboratory technician, suffered from severe depression for 20 years. He had tried everything: psychotherapy, anti-depressant drugs (several varieties) and a gruelling three-week course of electro-convulsive therapy. Nothing worked. Then his psychiatrist told him about an experimental operation using a technique called deep-brain stimulation (DBS) that was being conducted at Toronto Western Hospital, in Canada. In spite of the risk of brain haemorrhage, infection or seizure, Mr Matte signed the consent form. For him, the next step would have been suicide.

Mr Matte is one of six people who have been part of this pilot study into the use of DBS for treating depression. It is being carried out by Helen Mayberg, Andres Lozano and their colleagues at Toronto Western. Their results have just been published in *Neuron*, and though the sample is small, the outcome is astonishing. For Mr Matte and three others, the treatment worked completely. As soon as the electrodes implanted in their brains were switched on, they noticed a difference. Mr Matte describes how everything in the room became brighter. Lights and colours seemed more vivid. His depression vanished so dramatically that it left him feeling terrified—and it remained vanished, not only for the six months of the study, but also for the six months since it was completed. And none of the patients involved has experienced noticeable cognitive impairment as a result of the operation.

The study was conceived when Dr Mayberg discovered, using a brain-scanning technique called positron-emission tomography, that an area of the brain called the subgenual cingulate is overactive in patients with depression. This got her thinking. Neural overactivity is known or suspected in several other conditions, including chronic pain, dystonia, epilepsy, Tourette's syndrome, essential tremor, obsessive-compulsive disorder and Parkinson's disease. All of these illnesses may be treated with DBS. And in the case of Parkinson's disease it is known that the treatment dampens neural activity.

That is what happened in the successful cases in this experiment, too. Indeed, not only did electrical current fed into the subgenual cingulate suppress its activity, it also re-invigorated activity in the frontal cortex, the hypothalamus and the brainstem—all areas which themselves become dampened in depression.

There is a price to pay. Not only do patients have electrodes implanted in their brains, they also have a battery implanted into their chests (in the case of men) or their stomachs (in the case of women, to avoid damage to the breast tissue). But that is a small charge for resisting suicide.

According to the World Health Organisation, depression is the leading cause of disability in the world. Of the estimated 121m people who suffer from it, 15-30% have “refractory” cases like those treated by Dr Mayberg and Dr Lozano—that is, they do not respond to any treatment. If

bigger studies prove this new approach to treating refractory depression works on even a fraction of that fraction, neurosurgeons could be in for a busy time.

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Astrobiology

Life on Mars!!! (Not)

Mar 3rd 2005
From The Economist print edition

Martians, or the lack of them, sow discord on Earth

ONE can easily be forgiven for suffering confusion over whether life has been detected on Mars. On February 18th, America's space agency, NASA, moved quickly to quash reports that two of its scientists were about to announce strong evidence for it. Five days later Vittorio Formisano, an Italian scientist working with the European Space Agency (ESA), was keen to make just such a claim, and did so at a scientific meeting in the Netherlands. Most of his colleagues remain sceptical, but ESA, notably, has not issued any official denial. So what is going on?

The whole issue of life on Mars is a source of much scientific controversy. In a poll taken at a recent meeting of 250 scientists who study the planet, and released on February 25th, only one-quarter thought that life could exist there now. But nobody can truly say yea or nay yet. There are certainly signs that could be interpreted as evidence of life—in particular the presence of methane in the Martian atmosphere—but they are ambiguous. On Earth, methane is often associated with bacterial activity. But the methane on Mars may have a non-biological origin, such as a volcano.

What Dr Formisano did to fuel the debate was to announce that the instrument he is in charge of on ESA's *Mars Express* orbiter has detected a lot of formaldehyde. One way to make this chemical is to oxidise methane, and Dr Formisano claims that there is so much of the stuff in the Martian atmosphere that if it is there as a result of methane oxidation, then Mars must be producing about 2.5m tonnes of methane a year.

If that is the case, then either Mars is harbouring a lot of microbial life, or the planet is a lot more volcanically active than it looks at first sight. But perhaps it is. Gerhard Schwehm, head of planetary missions at ESA, says that *Mars Express* has also provided evidence of such recent geological activity. Moreover, not everyone is convinced that Dr Formisano's evidence actually proves that formaldehyde exists on Mars. The evidence has yet to be published in a journal.

Although NASA's researchers may not have discovered life on Mars, they have produced some interesting work that supports a biological explanation for the origin of the methane. Later this month Carol Stoker, of the agency's Ames Research Centre in California, and her colleagues, will tell the Lunar and Planetary Science conference in League City, Texas, that they have the first report of a subsurface ecosystem that can use sulphide minerals as an energy source.

Dr Stoker has been exploring a place on Earth that looks geochemically similar to an area of Mars called Sinus Meridiani. The place in question is near the source of the Rio Tinto, in Spain, and the similarity is the presence of a mineral called jarosite. The team drilled beneath the ground to take sample cores from up to 165 metres beneath the surface. There, they found a microbial ecosystem that appeared to be producing jarosite (a sulphate-based mineral) by oxidising rocks made of iron sulphide. One by-product of this process is methane, whose carbon comes from atmospheric carbon dioxide. And Mars, too, has carbon dioxide in its atmosphere. It has yet to be

established whether points of methane concentration in the Martian atmosphere coincide with jarosite deposits. If they do, though, the case for life on Mars will look a lot stronger than it does at the moment.

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Synaesthesia

Musical taste

Mar 3rd 2005
From The Economist print edition

A musical synaesthete

IN THE long tradition of neurological research, she is known only by her initials, to protect her anonymity. But ES is not ill. Indeed, she is almost the opposite of ill. For she is a professional musician who is able, literally, to taste what she hears. Almost every musical interval provokes a gustatory sensation in her. A major third sounds sweet. A minor third, salty. A fourth has the flavour of mown grass. Only an octave is tasteless.

Synaesthesia, as the stimulation of one sensory perception by another is known, is not that unusual. But the stimulated sensation is usually colour vision. Words or numbers, for example, take on reliable hues. In ES's case, that happens too. Individual tones have their own colours: C is red, F-sharp is violet. But her perception of intervals as flavours, reported in this week's *Nature* by Gian Beeli and his colleagues at the University of Zurich, is a phenomenon recorded only once before.

In the previous case, the individual in question, known as S, had no musical training, and tended to experience what the researchers refer to as “blended gustatory sensations”—in other words, entire meals rather than particular flavours. Dr Beeli speculates that ES's musical training has helped her to focus her synaesthesia on particular flavours. Whether the musical training focused the synaesthesia, or the synaesthesia provoked the passion for music, it is definitely the case that ES makes specific use of her synaesthesia to assist her professional life. For her, music truly is the food of love.

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German literature

Mourning has broken

Mar 3rd 2005
From The Economist print edition

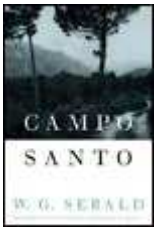
Corbis

W.G. Sebald had just begun to be widely recognised as one of the most lyrical and imaginative prose writers of his generation when he died

KNOWN to his friends and colleagues as Max, W.G. Sebald lived for more than three decades in England. He had been born in Germany in May 1944. Too late to be involved in the second world war, he was nonetheless wholly shaped by it—"as if those horrors I did not experience had cast a shadow over me, from which I shall never entirely emerge."

In 1966, after studying German literature at Freiburg University, he went to Britain, first to Manchester University and then as a lecturer to the University of East Anglia, where in 1987 he was appointed to the chair of German literature. Rural Suffolk became his home, a place he evokes again and again in "The Rings of Saturn", his fourth novel, or, as he preferred to call it, his "prose fiction". Suffolk was where Sebald could walk for hours without meeting a soul and where there was little to hinder his strange capacity for merging and dissolving the present into the past.

Campo Santo
By W.G. Sebald. Translated by Anthea Bell



Random House; 223 pages; $24.95.
Hamish Hamilton; £16.99

Buy it at
Amazon.com
Amazon.co.uk

In a sense, England represented a double exile for Sebald. In his view, Germany was also in exile—from its own history. Sebald grew up in a working-class family in a village in the Bavarian Alps amidst a profound silence about the war and the Holocaust, a silence that was intensified rather than broken when, at the age of 17, he and his schoolfellows were shown, without explanation or discussion, film footage of Bergen-Belsen.

The whole subject of forgetting and memory became Sebald's ruling passion. His work is impossible to categorise: a mix of memoir, biography, travelogue, local history, topography and meditation. Running through it all is his search for a language and a way of looking at the past without sentimentality or mythologising.

Eccentric, possessed of an almost comic ear for gothic melodrama and a child's innocent sensibility, Sebald took years to find his voice—and then he created only a small body of work. Just 11 years after “Vertigo”, his first book, came out, Sebald had a heart attack at the wheel of his car and was killed. He was 57.

By that time, he was already well known among readers of high literature. Sebald's death was widely reported in Europe, but in America, where he had only been published for five years, the obituaries were few, respectful and short. It is only with the posthumous publication of another three volumes of poetry, an essay collection, and now a last book of prose memoir, that Max Sebald has begun to be widely recognised as one of the most important prose writers of the past 20 years.

Sebald was always suspicious of rhetoric, of official days of commemoration and public mourning. He scorned the Holocaust industry and the feel-good sentiment of portrayals such as Thomas Keneally's “Schindler's Ark”. His vision lay in its essential privacy and obliqueness.

He could suggest the Nazi administrative machine without even mentioning it, simply by a deadpan description of Germany's minutely regulated silkworm industry a century before. Not that he avoided the thing itself. There is a searing prisoner-counting scene at Theresienstadt in “Austerlitz”, which came out in English just two months before his death. But truth, he believed, could best be ambushed at the peripheries—in the description, for example, of some tin soldiers, carefully set out on a windowsill, slowly heating up and melting as allied bombs fire the city.

This detail comes from the most recent and probably final collection of Sebald's essays, “Campo Santo”, in an appreciation of Alexander Kluge and other German writers of the 1950s—very few of whom, he says, could look clearly at their immediate past. There are a dozen works here, set in chronological order across 25 years, and placed after four fragments about Corsica, on which Sebald was working when he died. The essays are especially interesting in that they help to show a gradual loosening and release of Sebald's talent as a writer, a progression from strict footnoted argumentation to the almost recklessly fluid and digressive style that characterises his prose fiction.

These later pieces—on Nabokov, on Kafka and film, on Bruce Chatwin and others—all explore in their subjects the same uncanny sensibility that informs his own work: the sense of a silk-thin border between us and some “quasi- or extra-territorial” world, to use a favourite expression of his. There is an almost family-feeling in his understanding of Nabokov, for example—another émigré who was familiar with borders both real and metaphysical.

Sebald's writing can induce dizziness. Sentences, paragraphs, whole works drift and circle. The focus shifts; multiple narrators stretch the perspective. And yet, when you look up, something settles. Real vertigo, you realise, consists in the vanishing acts, the astounding erasures of history. There is a moment in “Austerlitz” when Sebald's narrator describes a paper mill he has heard of, where the water murmurs gently and the trees cast a perpetual twilight. There, he says, among the drying sheets of clean blank paper, “you wish for nothing more than eternal peace”. But this place of uninscribed paper is, of course, also a tabula rasa of the mind. This is the dream, the unreality, the siren's song that tempts the world to abandon history's, as well as Sebald's, strenuous injunction to remember.

By W.G. Sebald. Translated by Anthea Bell.

Random House; 223 pages; $24.95. Hamish Hamilton; £16.99
Hamish Hamilton; £16.99

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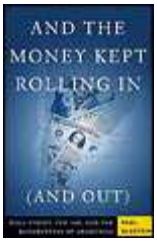
Argentina

Writing of the wreckage

Mar 3rd 2005
From The Economist print edition

IN THE 1990s, Argentina was held up as an exemplar of the "Washington consensus" of free-market reforms. In December 2001, after three years of slump and amid political and financial chaos, it declared the biggest sovereign-debt default in history. Following a traumatic devaluation, its economy is now recovering, but income per head is still below its 1998 level. As Paul Blustein, a financial reporter with the *Washington Post*, notes in his new book, Argentina has become "Exhibit A" for critics of globalisation and free markets.

And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina
By Paul Blustein



PublicAffairs; 278 pages; $27.50

Buy it at
Amazon.com
Amazon.co.uk

Wrongly so. The author stresses that those chiefly to blame were Argentina's own politicians and officials, who pursued an insufficiently rigorous fiscal policy to sustain a fixed exchange rate. He also explores the extent to which they were abetted by outsiders. In addition to Argentine officials, Mr Blustein also interviewed officers at the International Monetary Fund and its political master, the United States' Treasury.

The result is an engrossing inside account of how, despite the best of intentions, the Fund's two loans to Argentina in 2001 ended up merely prolonging the country's agony and increasing its debt burden. Wall Street investment banks raked in fees for issuing yet more Argentine bonds even as some of their analysts were privately gloomy about the country. Although he goes as far as calling one of his chapters "Enronization", the author does not believe that the investment banks' efforts amounted to fraud.

Mr Blustein rightly notes that the decisions facing policymakers were extremely difficult. The IMF was worried that it would be blamed for the recession that would follow if it withheld assistance. Argentines, who have a tendency to self-pity, duly blamed it both for doing this—and for not doing it earlier. The Fund has since admitted that it erred in its second 2001 loan (though the US Treasury continues to defend this) and, above all, in failing to be tougher on Argentina's fiscal laxity in the late 1990s. After carefully reviewing the debate on handling future debt crises, Mr Blustein concludes that new methods are needed to allow heavily indebted countries to carry out "voluntary" restructurings at an earlier stage.

Even if this were feasible, it is not clear that in Argentina's case it would have allowed a return to growth without further trauma, including an end to "convertibility" as the fixed exchange rate was called. Indeed, if Mr Blustein's book has a flaw, it is that it skates over a second, relevant, debate in global finance, which concerns exchange-rate policies. Wall Street, like most Argentines, was bedazzled by convertibility. A floating exchange rate, while no panacea, might have provided the early alarms and policy flexibility that Argentina lacked. The book fails to note that the original policy list of the Washington consensus (a term it omits to define) included a "competitive exchange rate". The arguments surrounding Argentina's collapse are complex and technical. It is

Mr Blustein's considerable achievement to have fashioned them into such a page-turner.

And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina. By Paul Blustein.
PublicAffairs; 278 pages; $27.50

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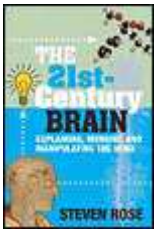
Neuroscience

Brain dead

Mar 3rd 2005
From The Economist print edition

THE human brain is remarkable in its ability to create order out of chaos. The goal of neuroscience is to understand just how the brain does this, and a good expository book should do the same thing. Unfortunately, what Steven Rose has learned, as a neurobiologist, about sorting order from chaos, does not translate into his new book of popular science.

The 21st-Century Brain: Explaining, Mending and Manipulating the Mind
By Steven Rose



Jonathan Cape; 344 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

"The 21st-Century Brain" promises, in its subtitle, to explain how neuroscience will allow the mind to be mended and manipulated, and to categorise what the possible implications of this mending and manipulation may be. This is a fascinating topic; indeed, there are few more interesting questions in science today. It is a shame, then, that Mr Rose waits until the last quarter of his book to begin addressing the subject in earnest. And when he does, it is in prose that somehow manages to be both hurried and laggardly at the same time, jumping back and forth between scientific research papers, television popularisations of neuroscience, and apocalyptic novels (primarily Aldous Huxley's "Brave New World") in such a way that the thread of his argument is all too often lost.

In an earlier book, "Alas, Poor Darwin", Mr Rose and his wife Hilary, a sociologist and frequent collaborator of his, assembled an excellent collection of essays attacking evolutionary psychology. "Alas" was a lively book that aimed to convince, rather than merely explain. Clearly accessible to the lay reader, it also stood smack in the middle of the intellectual debate about just how much evolution has to say about human behaviour. Even though it came out five years ago, "Alas" remains an excellent read.

Mr Rose's new book covers some of the same ground as "Alas", but in a more rushed and haphazard fashion. The main problem with "The 21st-Century Brain" may be that it is too short. It tries to do too much with too little—beginning, for instance, with a truncated and unsatisfying account of how life itself might have originated. This swollen scope brings in a slew of cross-references and pointers to other books on specific subjects, such as intelligence, the anatomy of the brain, or mind-altering drugs.

Mr Rose asks too much of the general reader, who may be seeking merely to gain a general, if informed, overview of what science might be able to do with people's brains in the near future.

Furthermore, the area with perhaps the most potential for progress in the next five years—the direct interaction between mind and machine—is given very short shrift in Mr Rose's book. Although researchers have, in the past two years, shown that electrodes directly implanted in the brain can be used, for instance, to move a cursor around a computer screen with just a thought, Mr Rose deals with the entire field in less than three pages. Instead, the book discusses mind-

altering drugs at some length, without looking much to the future (nods to Aldous Huxley's “soma” aside) of what such drugs might be able to do. All in all, this is a missed opportunity.

By Steven Rose.
Jonathan Cape; 344 pages; £20

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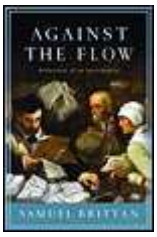
Peerless commentary

One of a kind

Mar 3rd 2005
From The Economist print edition

“THE origin of this book is my belief that some essays, lectures and short comments I have written over the last few years make more sense if read alongside each other—although not at a single sitting!” Coming from any other newspaper columnist, that would be a complacent or even boastful way to introduce a collection of previously published articles. Journalism, however astutely repackaged, rarely ages well; usually, collections only magnify the flaws. However, coming from Sir Samuel Brittan, peerless economic and political commentator long in residence at the *Financial Times*, the idea that a collection like this requires some such justification verges on false modesty. Sir Samuel's journalism does not age. This book is so good that rivals in the field will, like this reviewer, put it down not knowing whether to feel inspiration or despair.

Against the Flow
By Samuel Brittan



Atlantic Books; 385 pages; £25

Buy it at
Amazon.co.uk

It is not the range of the author's interests that is so unusual, although this is wide. “Against the Flow” includes pieces, grouped by theme, on terrorism and foreign policy, the arms trade, the European Union, individualism and collectivism, economics as a field of inquiry, and on notable thinkers such as John Maynard Keynes, Milton Friedman and Friedrich von Hayek. What is not merely rare but unique is the combination of coherence, penetration, lucidity and (above all) challenge to one's preconceptions.

Sir Samuel's articles express a consistent and meticulously thought-through view of the world—one that is deeply concerned with practical politics, but which repudiates conventional ideological labels, revealing the ordinary tug-of-war between the main political tribes as so much worthless blather. In these pages you find no remorseless partisan tub-thumping (Paul Krugman, take note); and (ditto, Tom Friedman) no talking down to readers with tortured simplifying metaphors, either. Sir Samuel addresses his readers as equals, paying them the compliment of assuming that they are as interested in the issues as he is, and willing to be stretched.

If any label were to fit, it would be “classical liberal”. Sir Samuel makes the case, moral and economic, for individuals over collectives, and for markets over coercion—ideas, as he points out, that put him at odds with conservatives as well as with liberals (in the modern American sense). He argues passionately against the arms trade, a view that aligns him with the orthodox left. He argues equally passionately that the American response to the terrorist attacks of September 11th 2001 was far closer to being correct than the response of America's European critics. This combination defies all ordinary categories. Yet it all fits together.

“Against the Flow” is the work of a remarkable journalist, a scholar and a profound thinker. Read it.

By Samuel Brittan.

Atlantic Books; 385 pages; £25

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Amazon worldwide bestsellers

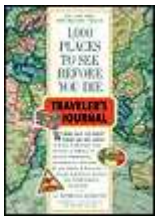
The big book index

Mar 3rd 2005
From The Economist print edition

The most popular travel books

WINTER is the season of discontent, which may be why armchair travel inspires such intense excitement. Three of Amazon's most popular travel books list the best places to visit before you die—Hawaii, the Galapagos, South America and the great Australian outback.

1. 1,000 Places to See Before You Die: Traveler's Journal.
By Patricia Schultz. *Workman Publishing Company; 972 pages; $18.95*



Seven years in the making this impressive tome is an around-the-world, continent-by-continent listing of islands, mountains and beaches, museums, monuments and more.

Click here to buy from Amazon.com or Amazon.co.uk

2. Maui Revealed: The Ultimate Guidebook, Second Edition.
By Andrew Doughty and Harriett Friedman. *Wizard Publications; 308 pages; $14.95. Cadogan Guides; £14.99*

What to do and see on Maui, written in a straightforward style by residents of this Hawaiian county.

Click here to buy from Amazon.com or Amazon.co.uk

3. Unforgettable Places to See Before You Die.
By Steve Davey and Marc Schlossman. *Firefly Books; 256 pages; $19.95. BBC Books; £18.99*

Forty of the best travel destinations in the world, including the Great Barrier Reef, Machu Picchu and the Galapagos Islands, illustrated with stunning photographs.

Click here to buy from Amazon.com or Amazon.co.uk

4. Long Way Round: Chasing Shadows Across the World.
By Ewan McGregor and Charley Boorman. *Atria; 320 pages; $26.95. Little, Brown; £18.99*

Two actors, two motorbikes and a four-month adventure around the world.

Click here to buy from Amazon.com or Amazon.co.uk

5.The Ultimate Kauai Guidebook: Kauai Revealed.

By Andrew Doughty and Harriett Friedman. *Wizard Publications; 256 pages; $14.95*

Another guide by residents, this time to the oldest of the main Hawaiian islands.

Click here to buy from Amazon.com or Amazon.co.uk

6. Hawaii—The Big Island Revealed: The Ultimate Guide.
By Andrew Doughty and Harriett Friedman. *Wizard Publications; 304 pages; $14.95*

A comprehensive and easy-to-use guidebook to the Big Island itself.

Click here to buy from Amazon.com or Amazon.co.uk

7. Birnbaum's Walt Disney World 2005: Expert: Advice from the Inside Source.
By Birnbaum. *Disney Editions; 256 pages; $16.95. Turnaround; £11.99*

The official guide that includes accurate information on prices and new attractions.

Click here to buy from Amazon.com or Amazon.co.uk

8. The Unofficial Guide to Walt Disney World 2005.
By Bob Sehlinger. *John Wiley; 816 pages; $18.99. Hungry Minds; £12.99*

The unofficial guide to the mother of all theme parks tells it exactly as it is.

Click here to buy from Amazon.com or Amazon.co.uk

9. Unforgettable Things to Do Before You Die.
By Steve Watkins and Clare Jones. Firefly Books; *256 pages; $19.95. BBC Books; £18.99*

Forty travel adventures around the world to tackle before the grim reaper calls.

Click here to buy from Amazon.com or Amazon.co.uk

10. The Travel Book: A Journey Through Every Country in the World.
By Roz Hopkins. *Lonely Planet Publications; 444 pages; $39.99 and £30*

The ultimate guide covering 230 countries by the masters of travel guidebooks.

Click here to buy from Amazon.com or Amazon.co.uk

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr and Amazon.jp from January 29th-February 25th. Prices are quoted from Amazon.com and Amazon.co.uk and are correct as of February 25th.

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The pain in painting

Little shop of horrors

Mar 3rd 2005 | TURIN
From The Economist print edition

An exhibition of cruelty and evil that is not for the faint-hearted

VITTORIO SGARBI has been many things, but never boring. Art critic, tele-celebrity, member of parliament for the ruling Forza Italia party, Mr Sgarbi courts controversy as avidly as he pursues women and art. He earned international scorn for refusing, while briefly serving as Silvio Berlusconi's under-secretary of culture, to return the Aksum obelisk stolen by Mussolini to Ethiopia. He is both loved and loathed by his compatriots, in part because he has been able to turn art, which in Italy is often treated with dull reverence, into a sensational media event.

Now Mr Sgarbi has curated a show on the subject of cruelty and evil in western art, from the Middle Ages to today. Containing nearly 200 works, including paintings, carvings, newsreels and comic strips, the exhibition is almost as baroque as the gorgeous Stupinigi hunting lodge outside Turin, where it is displayed.

The show opens with a portrait of an unknown man by a 15th-century Italian painter, Antonello da Messina; the picture has been vigorously scratched about the subject's face, perhaps by one of the faithful who, in the 14th and 15th centuries, commonly attacked representations of demons in paintings. The exhibition ends with a newsreel of the planes hitting the twin towers on September 11th 2001.

For Mr Sgarbi, these images represent the two key ideas of the show: evil as both an individual and communal experience that entails destruction. “We don't know why Antonello's painting was attacked. But it shows an individual viewer's personal fight against the evil he saw in that painting. On the other hand I see the film of the attack on the twin towers as an image of mass destruction that defines 21st-century society,” Mr Sgarbi explains.

The show's Italian title, “Il Male”, has a wider meaning in English, encompassing pain, suffering, cruelty and horror, all of which appear in abundance. There are walls of beheaded John the Baptists, not to mention a particularly bloody Christ crowned with thorns, St Agnes looking heavenward as her breasts are sliced off, Medusas with snakes in their hair and St John the Evangelist being boiled alive, although he appears to be singing in the bath.

Mr Sgarbi's theories

Of course, bad things do not just happen to Christians and this exhibition overflows with classical horrors, from the soft-porn portrayals of the rape of Lucretia to the death of Cleopatra with the asp nibbling at her nipple (this particular work, like many others in the show, comes from Mr Sgarbi's private collection). Gruesome scenes from literature also feature, including a painting by Donato Mascagni of Dante's famous Count Ugolino, who was imprisoned with his sons in the *Inferno* and who survived by eating them. Meanwhile images of witches' sabbaths and satanic

rituals abound, perhaps a nod to Turin, said to be the black-magic capital of Italy.

Why put on such a show? “I have a theory that the first ten years of each century contain the seeds of what comes afterwards,” Mr Sgarbi opines. “Our own century has been marked by the catastrophe of the twin towers. Because of this, I decided to dedicate an exhibition to looking at evil through the ages.”

Mr Sgarbi's unrivalled connections have certainly enabled him to procure often inaccessible pictures. He treats Italy like his own private attic, coaxing a few famous but mostly obscure old masters out of private collections, regional museums, palaces and churches. A surprising coup is Caravaggio's massive “Burial of St Lucy” which came from the Palazzo Bellomo museum in Syracuse, Sicily. The picture had been destined for the Caravaggio blockbuster that opened at London's National Gallery last month. At the last minute, however, the loan was refused, on the grounds that the painting required urgent restoration. Somehow it has materialised here, where the harsh lighting illuminates the painting's terrible state of preservation—a condition that may worsen in the damp and all-too-crowded rooms of this exhibition.

It is also clear that this theatrical curator prefers shock to reflection. He channel-hops through art history, picking out the most grotesque moments. In the sketchy 20th-century section, documentary footage from Auschwitz plays alongside broadcasts of vacuous Italian television-dating shows, presumably to make the point that brain-sapping TV is an evil of our time. But Mr Sgarbi's comparisons amount to a case of the pot calling the kettle black, particularly when he refers to children being ushered to the gas chambers as “cute” and the twin towers footage as a “work of art”.

The curator scorns questions of impropriety. “This is not an exhibition made by priests. I am not a moralist. I am showing people art, not telling them what to think.” But one cannot help feeling that he speaks in eloquent half-truths, demonstrating an uncomfortable affinity to those *ancien régime* libertines for whom cruelty and seduction were just an elaborate game. By refusing to engage with the more troubling aspects of his theme, he turns his exhibition into a horror show, where visitors are not viewers but voyeurs.

That said, all of this—and Mr Sgarbi's notoriety too—should guarantee the show huge audiences, despite the desultory quality of much of the work on display. A few of the paintings here are excellent and many of them are rarely to be seen in public. But taking the exhibition as a whole, “Il Male” makes no real sense. Mr Sgarbi might argue that evil similarly makes no sense, but that it persists and he is showing how it has been portrayed in visual culture. If one looks without understanding, though, how can one ever learn?

“Il Male: Esercizi di Pittura Crudele” is at Palazzina di Caccia di Stupinigi, Piazza Principe Amedeo 7, Stupinigi-Nichelino (Turin), until June 26th.

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Obituary

Peter Benenson

Mar 3rd 2005
From The Economist print edition

Corbis

Peter Benenson, champion of conscience, died on February 25th, aged 83

THE pen may be mightier than the sword; but as a means of putting pressure on despotic governments, it hardly seems up to the task. A neatly typed missive from north London or Connecticut, addressed to “Dear General X” and ending “Yours sincerely”, cannot last long on a desk piled with spy reports and death warrants. The whimsical futility of the technique brings to mind the poet Shelley, who in 1812 stuffed copies of his “Declaration of Rights” (reminding the repressive Regency regime of the importance of free speech) into little waxed boxes and empty bottles, and set them afloat in the Bristol Channel.

When Peter Benenson, in 1960, first conceived his idea of freeing prisoners of conscience by a letter-writing campaign, he was thought just as foolish. Certainly the idea came out of the blue. He had got on the London Underground to go to work as usual, that November morning, in his chambers in the Temple, bowler hat on head and *Daily Telegraph* rolled under his arm. He ended up sitting for 45 minutes in the church of St Martin-in-the-Fields, thinking. What had caused him to change course was a story in the paper of two Portuguese students who, for raising their glasses in a toast to liberty in a café in Lisbon, had been jailed for seven years.

Mr Benenson had intended to protest outside the Portuguese embassy. But he was hardly dressed to strike fear into the regime of António Salazar. Nor, a mere lawyer, could he hope to wield much influence over him. As a leading member of the Society of Labour Lawyers, Mr Benenson had gone on several trips in the 1950s to observe trials of trade unionists and Basque nationalists in

Franco's Spain. Both the trials and the prisons had outraged him but, unless he could collar the trial judge over dinner, he could find no audience for his passionate appeals on behalf of freedom of speech.

He decided, therefore, to mobilise middle England. In May 1961, in an article in the *Observer* newspaper, he outlined the cases of several “forgotten prisoners” for whom, he was sure, “if...feelings of disgust could be united into common action, something could be done.” He proposed a 12-month “Amnesty” campaign of letter-writing to free them. Within six months, thousands of letters had arrived. Within the year, Amnesty groups had been set up in a dozen countries, becoming the germ of what is now the world's biggest independent human-rights organisation. By last year, Amnesty International had taken on more than 47,000 prisoner cases and had closed 45,000 of them. Much of the world's consciousness of human rights and wrongs—even if that consciousness is still, in many places, lip service—stemmed from Mr Benenson's epiphany in the middle of Trafalgar Square.

Voltaire's example

Like many children of privilege—Russian oil money, private tutoring from W.H. Auden, Eton, Oxford—Peter Benenson became a socialist young, when he saw unemployed Welsh miners marching through the streets of Windsor. At school he protested in “revolutionary” fashion against the dinners, and raised money to rescue Jewish teenagers from Germany. As the head of Amnesty, however, he strove to be non-ideological. His first roll-call of “prisoners of conscience” included Cardinal Jozsef Mindszenty, imprisoned by the communists, as well as the victims of right-wing dictators. Despite his alliance, financial as well as moral, with the leftish *Observer*, he managed to promote Amnesty as simply committed to free speech and fair trials. His motto, he said, was Voltaire's: “I detest what you say, but I am prepared to die for your right to say it.”

Like any association of free-thinkers, Amnesty had its troubles. Several of them sprang from Mr Benenson's impulses to spend money freely, to disregard budgets (save what might be scribbled on the back of a cigarette packet), and to throw himself headlong into causes. In 1966, he became convinced that a colleague was covering up atrocities by the British forces in Aden; the suspicion was groundless, and he was obliged to resign. Reconciled again, after years in the wilderness, he embraced the cause of Mordecai Vanunu, the leaker of Israel's nuclear secrets. Amnesty as a whole disagreed with him, and kept its distance.

Mr Benenson was offered several honours, but refused them all. When an ingratiating letter came from a prime minister, he would write back politely with a catalogue of the government's own human-rights abuses. He always felt there was far to go, both at home and abroad. For him, Amnesty's logo of a candle in barbed wire represented not a flame of hope, but every prisoner who had died unreleased and every victim still tortured. He himself died in the very week that proposals for extra-judicial house arrest for terrorist suspects, a bald violation of civil liberties, were going through Britain's Parliament.

But his letter campaign had been effective beyond all precedent, in big ways and small. Julio de Peña Valdez, a trade unionist imprisoned in the Dominican Republic, remembered that when the first 200 letters arrived, in the summer of 1975, he was given his clothes back. When 200 more arrived, the head of the prison came to see him. When 3,000 came, the president, exasperated, ordered his release.

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Overview

Mar 3rd 2005
From The Economist print edition

The growth of **America's** GDP in the year to the fourth quarter was revised upward to 3.9% from the previous estimate of 3.7%. The ISM index of manufacturing activity fell by more than expected in February to 55.3, although it still indicates expansion.

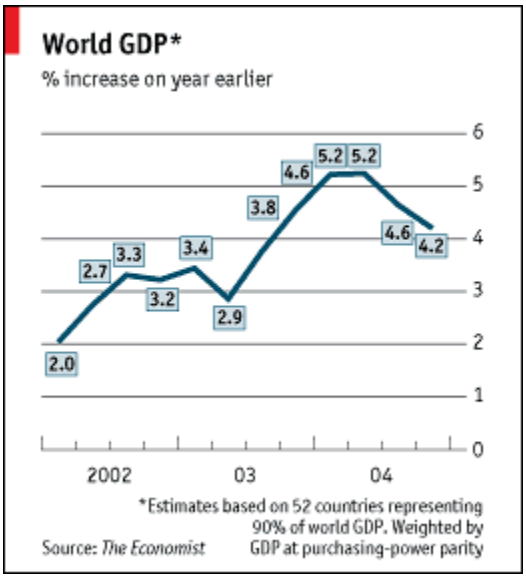
Inflation in the **euro area** ran at 2.0% in the 12 months to February, up from 1.9% in the year to January. Unemployment in **France** rose to 10.0% in January, the highest level in five years. In **Germany**, another 161,000 people were added to the ranks of the unemployed in February, thanks partly to the effects of recent labour-market reforms. Just over 5.2m Germans are now unemployed, the highest level since the 1930s. The jobless rate in February rose to 11.7%.

Despite disappointing GDP figures recently**, Japan's** industrial production rose by 1.1% in the year to January.

Canada's economy grew by 3.0% in the year to the fourth quarter.

GDP in **Australia** grew by only 0.1% in the fourth quarter of last year, its slowest rate for four years. That left GDP 1.5% higher than a year earlier, down from annual growth of 4.5% in the fourth quarter of 2003. Despite this, the Reserve Bank of Australia raised interest rates by a quarter point, to 5.5%, because of concerns that the tight labour market could cause inflation to rise.

The growth of **global** GDP slowed late last year. *The Economist*'s world GDP indicator grew by 4.2% in the year to the fourth quarter, down from 5.2% in the first half of last year. Countries that account for 76% of world output have now published their fourth-quarter GDP numbers.



Output, demand and jobs

Mar 3rd 2005
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest	qtr*	2004	2005	latest		latest		latest		year ago
Australia	+ 1.5 Q4	+ 0.6	+ 3.4	+ 3.1	+ 4.2	Q3	+ 2.2	Q4	5.1	Jan	5.7
Austria	+ 2.7 Q3	+ 3.2	+ 1.7	+ 2.1	+ 5.4	Dec	+ 7.0	Nov	4.5	Feb	4.4
Belgium	+ 2.6 Q4	nil	+ 2.6	+ 2.1	+ 0.3	Dec	+ 5.9	Dec	12.7	Jan†	12.9
Britain	+ 2.8 Q4	+ 3.0	+ 3.0	+ 2.4	+ 0.3	Dec	+ 3.9	Jan	4.7	Dec††	4.9
Canada	+ 3.0 Q4	+ 1.7	+ 2.7	+ 3.0	+ 3.3	Dec	+ 4.8	Nov	7.0	Jan	7.3
Denmark	+ 2.2 Q4	+ 2.7	+ 2.0	+ 2.0	+ 4.1	Dec	+ 6.1	Jan	6.2	Dec	6.7
France	+ 2.1 Q4	+ 2.8	+ 2.1	+ 1.9	+ 2.0	Dec	+ 2.8	Dec	10.0	Jan	9.9
Germany	+ 1.5 Q4	– 0.9	+ 1.2	+ 1.3	+ 0.6	Dec	– 1.1	Jan	11.7	Feb§	10.3
Italy	+ 1.0 Q4	– 1.2	+ 1.3	+ 1.4	– 3.2	Dec	– 2.1	Nov	7.7	Jun	8.6
Japan	+ 0.6 Q4	– 0.5	+ 3.0	+ 1.6	+ 1.1	Jan	– 1.0	Dec	4.5	Jan	5.0
Netherlands	+ 1.3 Q4	– 0.3	+ 1.3	+ 1.3	+ 0.1	Dec	– 0.6	Nov	6.5	Jan**	6.1
Spain	+ 2.7 Q4	+ 3.2	+ 2.4	+ 2.4	+ 1.3	Dec	+ 2.5	Dec	10.4	Dec	11.2
Sweden	+ 3.9 Q3	+ 3.8	+ 3.4	+ 2.9	– 3.7	Dec	+ 6.9	Jan	5.5	Jan†	5.9
Switzerland	+ 1.2 Q4	– 0.3	+ 1.7	+ 1.7	+ 3.5	Q3	– 0.5	Dec	4.1	Jan†	4.3
United States	+ 3.9 Q4	+ 3.8	+ 4.3	+ 3.5	+ 4.0	Jan	+ 4.9	Jan	5.2	Jan	5.7
Euro area	+ 1.6 Q4	+ 0.8	+ 1.8	+ 1.6	+ 1.0	Dec	+ 0.5	Dec	8.9	Dec	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 3.6 Q4	+ 2.5	na	na	+ 1.1	Jan	+ 5.1	Dec	9.8	Jan†	9.5
Greece	+ 4.0 Q4	nil	na	na	– 0.9	Dec	+ 2.8	Nov	10.7	Mar	9.8
Iceland	+ 7.4 Q3	na	na	na	na		na		2.7	Dec†	3.4
Ireland	+ 5.8 Q3	na	na	na	+ 0.3	Dec	+ 3.4	Dec	4.2	Jan	4.4
Luxembourg	+ 2.12003	na	na	na	+ 2.4	Nov	+ 5.4	Nov	4.7	Jan	4.4
New Zealand	+ 4.0 Q3	+ 1.9	na	na	+ 4.5	Q3	+ 6.8	Q4	3.6	Q4	4.5
Norway	+ 1.8 Q3	– 3.9	na	na	– 0.5	Dec	+ 2.4	Dec	4.1	Jan‡	4.3
Portugal	+ 0.8 Q3	– 4.9	na	na	– 2.1	Dec	+ 5.2	Dec	7.1	Q4†	6.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Oct-Dec; claimant count rate 2.6% in Jan.
§EU harmonised rate 10.0% in Dec. **Nov-Jan.

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Prices and wages

Mar 3rd 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.6	Q4	+ 2.4	+ 2.3	+ 2.4	+ 8.2	Q4	– 1.1	+ 3.7	Q3	+ 5.1
Austria	+ 2.9	Jan	+ 1.1	+ 2.0	+ 1.7	+ 4.7	Jan	+ 2.2	+ 2.0	Dec	+ 2.3
Belgium	+ 2.6	Feb	+ 1.3	+ 2.0	+ 1.8	+ 3.3	Jan	+ 1.9	+ 2.4	Oct	+ 1.8
Britain	+ 1.6	Jan*	+ 1.4	+ 1.5	+ 1.7	+ 2.6	Jan	+ 1.6	+ 4.3	Dec†	+ 3.4
Canada	+ 2.0	Jan	+ 1.2	+ 1.9	+ 2.0	+ 3.8	Dec	– 3.5	+ 2.5	Dec	+ 5.1
Denmark	+ 1.0	Jan	+ 1.1	+ 1.1	+ 1.6	+ 3.0	Jan	+ 0.3	+ 2.8	Q4	+ 3.5
France	+ 1.6	Jan	+ 2.0	+ 2.2	+ 1.6	+ 2.8	Jan	+ 0.3	+ 3.0	Q4	+ 2.7
Germany	+ 1.8	Feb	+ 0.9	+ 1.7	+ 1.3	+ 3.4	Jan	+ 0.4	+ 1.5	Dec	+ 1.5
Italy	+ 1.9	Feb	+ 2.3	+ 2.2	+ 2.0	+ 4.5	Jan	+ 0.4	+ 3.3	Dec	+ 2.7
Japan	– 0.1	Jan	– 0.3	nil	+ 0.3	+ 1.3	Jan	nil	– 0.5	Dec	+ 3.0
Netherlands	+ 1.5	Jan	+ 1.3	+ 1.3	+ 1.2	+ 5.2	Dec	– 0.3	+ 0.7	Jan	+ 1.7
Spain	+ 3.1	Jan	+ 2.3	+ 2.8	+ 2.7	+ 4.8	Jan	+ 0.7	+ 2.2	Q3	+ 3.1
Sweden	nil	Jan	+ 0.8	+ 0.6	+ 1.3	+ 2.5	Jan	– 2.1	+ 2.0	Dec	+ 2.8
Switzerland	+ 1.4	Feb	+ 0.1	+ 0.9	+ 1.1	+ 1.3	Jan	– 0.2	+ 1.4	2003	+ 1.8
United States	+ 3.0	Jan	+ 1.9	+ 2.7	+ 2.4	+ 4.2	Jan	+ 3.0	+ 2.6	Jan	+ 2.0
Euro area	+ 2.0	Feb	+ 1.6	+ 2.1	+ 1.7	+ 3.9	Jan	+ 0.3	+ 2.0	Q3	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.2	Jan	+ 0.2	na	na	+ 1.2	Jan	– 0.7	+ 3.1	Q3	+ 4.3
Greece	+ 4.0	Jan	+ 2.9	na	na	+ 2.9	Dec	+ 2.1	na		na
Iceland	+ 4.5	Feb	+ 2.3	na	na	+ 8.6	Jan	+ 1.3	+ 6.0	Dec	+ 5.4
Ireland	+ 2.3	Jan	+ 1.8	na	na	– 0.4	Jan	– 8.2	+ 4.5	Q3	+ 4.6
Luxembourg	+ 2.0	Jan	+ 2.1	na	na	+17.0	Dec	+ 0.1	+ 2.5	Nov	na
New Zealand	+ 2.7	Q4	+ 1.6	na	na	+ 3.4	Q4	– 0.1	+ 2.5	Q4	+ 2.3
Norway	+ 1.1	Jan	– 1.8	na	na	+11.7	Jan	– 0.1	+ 4.6	Q3	+ 4.2
Portugal	+ 2.0	Jan	+ 2.3	na	na	+ 4.2	Jan	– 0.3	– 0.6	Dec	– 2.9

*New series. RPI inflation rate 3.2% in Jan. †Oct-Dec.

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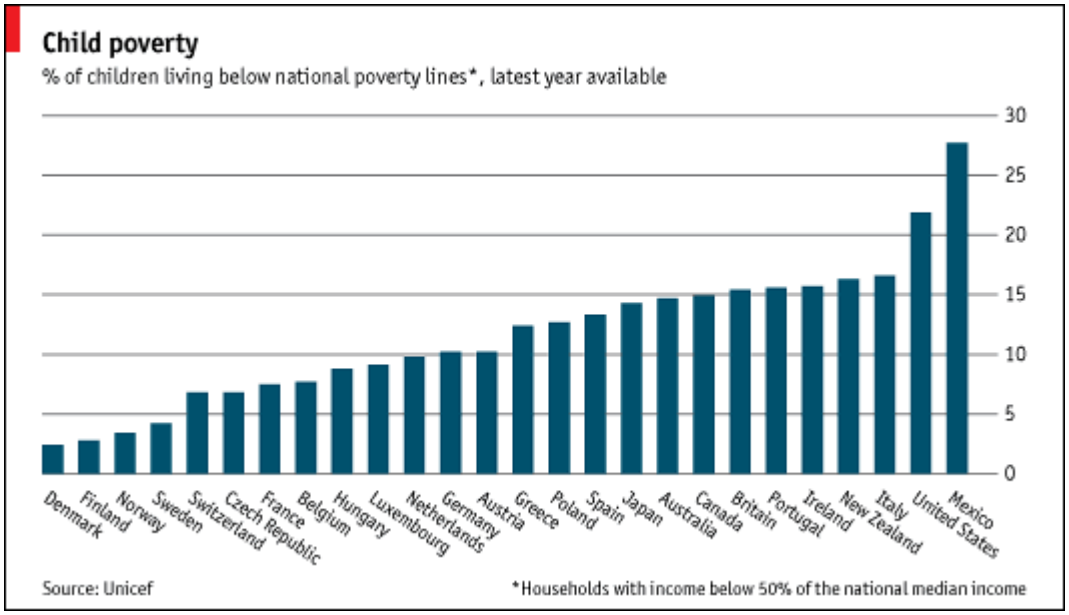
Child poverty

Mar 3rd 2005
From The Economist print edition



Child poverty has increased in much of the rich world over the past decade, according to a new report from UNICEF. While Nordic countries have less than 5% of their children living in poverty, defined in relative terms, more than a fifth of youngsters in America are classified as poor. UNICEF stresses the importance of government spending on family and social benefits in reducing the proportion of poor children.

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Money and interest rates

Mar 3rd 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Mar 2nd 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 2.5	+ 9.5	Jan	5.76	5.55	5.51	5.57	5.61	6.48
Britain	+ 5.7	+ 8.9	Jan	4.91	4.19	4.82	4.83	4.86	5.23
Canada	+13.9	+ 9.9	Jan	2.42	2.12	2.95	4.37	4.36	5.62
Denmark	+13.5	+ 9.5	Jan	2.25	2.15	2.48	3.82	4.23	5.09
Japan	+ 4.2	+ 2.0	Jan	0.02	0.03	0.14	1.50	1.40	1.57
Sweden	+ 2.1	+ 4.5	Jan	1.96	2.41	2.15	3.89	4.49	2.16
Switzerland	– 5.6	+ 1.7	Jan	0.76	0.26	1.22	2.21	2.43	2.27
United States	+ 4.9	+ 5.9	Jan	2.82	1.04	3.55	4.38	4.05	5.35
Euro area†	+ 9.6	+ 6.6	Jan	2.14	2.06	2.46	3.74	4.07	3.88

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.74%, Japan No. 267 1.50%. Central bank rates: US fed funds 2.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Mar 3rd 2005
From The Economist print edition

2000=100

	Feb 22nd	Mar 1st*	% change on one month	% change on one year
Dollar index				
All items	132.2	134.9	+ 7.3	– 2.1
Food	123.7	128.1	+ 9.7	– 6.6
Industrials				
All	143.3	143.6	+ 4.7	+ 3.5
Nfa†	128.1	131.0	+ 4.1	–10.6
Metals	151.6	150.5	+ 5.0	+12.0
Sterling index				
All items	105.2	106.5	+ 5.0	– 5.8
Euro index				
All items	92.5	94.6	+ 5.8	– 8.7
Yen index				
All items	127.9	130.7	+ 7.7	– 7.2
Gold				
$ per oz	434.35	432.25	+ 2.9	+ 9.8
West Texas Intermediate				
$ per barrel	50.67	51.64	+ 9.5	+41.1

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Mar 3rd 2005
From The Economist print edition

Market indices

		2005		% change on one week	% change on record high	Dec 31st 2004 in local currency	Dec 31st 2004 in $ terms
	Mar 2nd	high	low				
Australia (All Ordinaries)	4,172.2	4,182.9	4,033.3	+ 1.7	– 0.3	+ 2.9	+ 2.8
Austria (ATX)	2,691.1	2,704.0	2,415.0	+ 4.3	– 0.5	+10.7	+ 6.8
Belgium (Bel 20)	3,097.7	3,128.9	2,958.8	+ 1.4	–15.9	+ 5.6	+ 1.9
Britain (FTSE 100)	4,992.8	5,060.8	4,783.6	+ 0.1	–28.0	+ 3.7	+ 3.2
Canada (Toronto Composite)	9,800.1	9,800.1	9,006.2	+ 1.3	–13.9	+ 6.0	+ 2.3
Denmark (KBX)	282.4	282.4	257.8	+ 2.5	– 6.4	+ 9.5	+ 5.6
France (SBF 250)	2,815.1	2,815.1	2,633.6	+ 2.1	–35.9	+ 6.9	+ 3.1
(CAC 40)	4,062.7	4,062.7	3,816.1	+ 2.2	–41.3	+ 6.3	+ 2.6
Germany (DAX)	4,393.4	4,402.0	4,201.8	+ 1.9	–45.5	+ 3.2	– 0.4
Italy (S&P/MIB)*	31,933.0	32,371.0	30,645.0	+ 1.7	–36.3	+ 3.3	– 0.3
Japan (Nikkei 225)	11,813.7	11,813.7	11,238.4	+ 2.7	–69.6	+ 2.8	+ 0.5
(Topix)	1,185.7	1,185.7	1,132.2	+ 2.8	–58.9	+ 3.1	+ 0.8
Netherlands (AEX)	376.3	376.3	350.1	+ 1.5	–46.4	+ 8.1	+ 4.3
Spain (Madrid SE)	1,010.8	1,025.8	950.9	+ 1.1	–11.8	+ 5.4	+ 1.7
Sweden (Affarsvarlden Gen)	234.8	234.8	218.9	+ 2.3	–41.4	+ 6.1	+ 1.9
Switzerland (Swiss Market)	6,013.4	6,013.4	5,669.6	+ 2.5	–28.5	+ 5.6	+ 2.1
United States (DJIA)	10,812.0	10,841.6	10,368.6	+ 1.3	– 7.8	+ 0.3	+ 0.3
(S&P 500)	1,210.1	1,211.4	1,163.8	+ 1.6	–20.8	– 0.2	– 0.2
(NASDAQ Comp)	2,067.5	2,152.2	2,008.7	+ 1.8	–59.0	– 5.0	– 5.0
Europe (FTSEurofirst 300)†	1,100.2	1,103.2	1,038.6	+ 1.4	–35.5	+ 5.6	+ 1.9
Euro area (FTSE Euro 100)†	942.9	944.6	894.4	+ 1.8	–39.2	+ 4.7	+ 1.0
World (MSCI)‡	1,177.9	1,180.0	1,128.2	+ 1.5	–18.7	+ 0.7	+ 0.7
World bond market (Citigroup)††	650.9	662.3	648.6	– 0.6	– 2.4	– 2.3	– 2.3

*New index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.

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Trade, exchange rates and budgets

Mar 3rd 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Mar 2nd	year ago	Currency units per $ Mar 2nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	– 18.2	Jan	– 39.4	Q4	– 6.0	– 5.4	88.5	88.4	1.28	1.34	2.44	1.68	1.22	+ 0.7
Austria	nil	Dec	– 0.9	Dec	– 0.6	– 0.7	106.1§	105.1	0.76	0.82	1.46	–	0.73	– 1.5
Belgium	+ 20.9	Dec	+ 11.7	Sep	+ 3.7	+ 3.5	106.7§	105.4	0.76	0.82	1.46	–	0.73	– 0.1
Britain	–105.5	Dec	– 47.4	Q3	– 2.3	– 2.6	103.9	105.9	0.52	0.55	–	0.69	0.50	– 3.2
Canada	+ 51.6	Dec	+ 23.4	Q4	+ 2.7	+ 2.1	92.0	86.0	1.24	1.35	2.37	1.63	1.18	+ 1.1
Denmark	+ 9.8	Dec	+ 5.8	Dec	+ 2.9	+ 2.8	107.0	106.4	5.68	6.14	10.8	7.44	5.41	+ 0.9
France	– 9.6	Dec	– 5.3	Dec	nil	+ 0.1	110.6§	109.1	0.76	0.82	1.46	–	0.73	– 3.7
Germany	+194.2	Dec	+ 96.0	Dec	+ 3.0	+ 3.0	108.5§	106.7	0.76	0.82	1.46	–	0.73	– 3.9
Italy	– 0.7	Dec	– 12.6	Dec	– 0.9	– 1.0	78.6§	77.5	0.76	0.82	1.46	–	0.73	– 2.9
Japan	+132.3	Dec	+171.8	Dec	+ 3.6	+ 3.5	135.9	134.1	105	110	200	138	–	– 6.5
Netherlands	+ 37.0	Dec	+ 24.1	Q4	+ 3.0	+ 3.1	106.2§	104.9	0.76	0.82	1.46	–	0.73	– 2.9
Spain	– 75.5	Dec	– 44.5	Nov	– 3.1	– 3.4	78.6§	77.9	0.76	0.82	1.46	–	0.73	– 1.1
Sweden	+ 23.1	Jan	+ 28.0	Q4	+ 6.4	+ 5.7	82.6	80.3	6.92	7.62	13.2	9.08	6.60	+ 0.5
Switzerland	+ 8.3	Jan	+ 44.7	Q3	+12.5	+12.1	113.6	109.8	1.18	1.30	2.25	1.54	1.12	– 1.6
United States	–666.2	Dec	–603.2	Q3	– 5.6	– 5.9	91.1	97.6	–	–	1.91	1.31	0.95	– 4.4
Euro area	+ 92.5	Dec	+ 52.1	Dec	+ 0.5	+ 0.6	93.1	90.5	0.76	0.82	1.46	–	0.73	– 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.9	Dec	+ 8.6	Dec	na	na	84.3§	83.2	0.76	0.82	1.46	–	0.73	+ 2.3
Greece	– 31.7	Dec	– 10.0	Dec	na	na	60.7§	60.5	0.76	0.82	1.46	–	0.73	– 5.3
Iceland	– 0.5	Dec	– 0.6	Q3	na	na	96.6**	93.2	80.5	71.9	117	80.6	58.6	+ 0.1
Ireland	+ 42.0	Dec	– 1.6	Q3	na	na	99.9§	97.8	0.76	0.82	1.46	–	0.73	+ 0.2
Luxembourg	– 4.5	Dec	+ 2.3	Q3	na	na	106.7§	105.4	0.76	0.82	1.46	–	0.73	– 0.4
New Zealand	– 2.7	Jan	– 5.3	Q3	na	na	110.2	106.1	1.38	1.50	2.64	1.81	1.32	+ 2.9
Norway	+ 34.5	Jan	+ 33.8	Nov	na	na	98.7	93.2	6.27	7.11	12.0	8.22	5.98	+ 8.2
Portugal	– 18.5	Nov	– 13.3	Dec	na	na	94.0**	93.4	0.76	0.82	1.46	–	0.73	– 2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate.
**IMF, October average.

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Exchange-rate forecasts

Mar 3rd 2005
From The Economist print edition

Exchange-rate forecasts

Currency units per dollar

	Mar 1st	3-month	12-month
Euro area*	1.32	1.38	1.34
Japan	104	96	100
Australia	1.27	1.22	1.23
Britain†	1.92	1.99	1.91
Canada	1.24	1.22	1.26
Denmark	5.65	5.4	5.54
Sweden	6.86	6.66	6.72
Switzerland	1.17	1.07	1.12
China	8.28	7.95	7.7
Singapore	1.62	1.59	1.58
South Korea	1,003	985	1,000
Brazil	2.6	2.65	2.8
Mexico	11.1	11.4	11.9
Poland	2.96	2.86	2.84
Russia	27.7	27.3	27.7
South Africa	5.85	5.6	5.85

Source: J.P. Morgan Chase *$ per € †$ per £

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Overview

Mar 3rd 2005
From The Economist print edition

Brazil's GDP grew by 5.2% in 2004, the fastest pace in ten years, thanks partly to booming exports. The trade surplus widened to $35.1 billion in the 12 months to February.

Thailand's current account fell from a $1.37 billion surplus in December to a $942m deficit in January.

In February, the 12-month inflation rate fell to 16.9% in **Venezuela**, down from 21.9% a year earlier.

In the year to January, industrial production grew by 14.2% in **South Korea** and by 13.0% in **Taiwan**.

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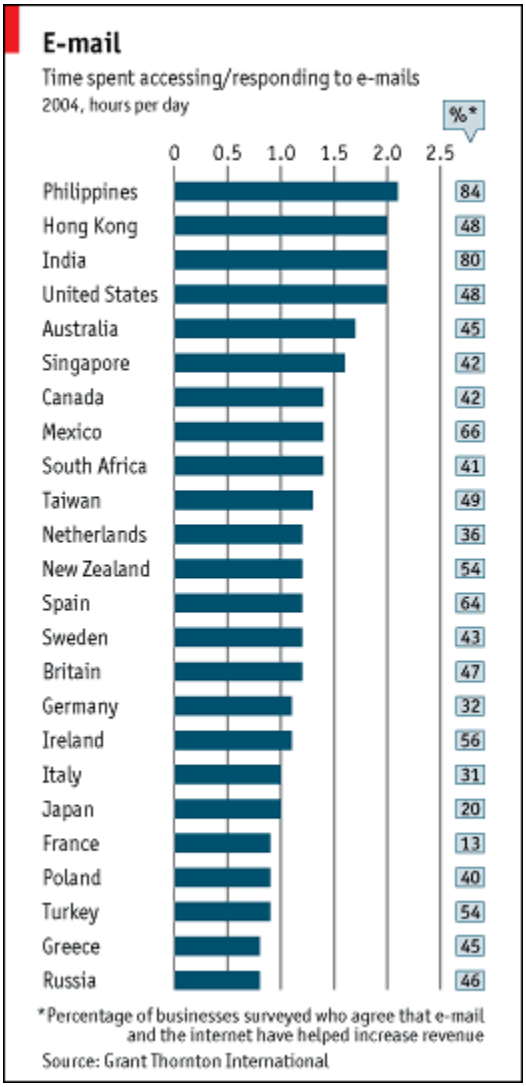
E-mail

Mar 3rd 2005
From The Economist print edition

E-mail is almost universally used by businesses around the world, according to the 2005 International Business Owners Survey carried out by Grant Thornton, an accountancy firm. But there are wide variations between countries in both levels of usage and attitudes. Business owners in the Philippines spend the most time, an average of 2.1 hours a day, dealing with e-mail. Firms in the Philippines, India and Mexico were most likely to report that use of the internet had increased their revenues. But a mere 13% of companies in France, the nation with the most sceptical attitude, agreed.



Economy

Mar 3rd 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q4	+14.4	Dec	+ 1.9	Jan	+38.4	Jan	+45.9	2003	609.9	Dec
Hong Kong	+ 7.2	Q3	+ 3.4	Q3	– 0.5	Jan	–12.4	Jan	+14.2	Q3	124.7	Jan
India	+ 6.6	Q3	+ 7.9	Dec	+ 4.4	Jan	–23.6	Jan	+ 3.5	Q3	123.7	Jan
Indonesia	+ 6.7	Q4	– 2.3	Aug	+ 7.2	Feb	+24.5	Jan	+ 4.0	Q3	34.8	Jan
Malaysia	+ 5.6	Q4	+ 5.8	Dec	+ 2.4	Jan	+21.3	Dec	+14.7	Q3	68.8	Jan
Philippines	+ 5.4	Q4	+ 5.7	Dec	+ 8.4	Jan†	– 0.7	Dec	+ 4.4	Sep	12.9	Jan
Singapore	+ 6.5	Q4	+ 9.9	Jan	+ 0.9	Jan	+15.4	Jan	+27.9	Q4	112.0	Jan
South Korea	+ 4.6	Q3	+14.2	Jan	+ 3.3	Feb	+30.3	Feb	+29.1	Jan	199.6	Jan
Taiwan	+ 3.3	Q4	+13.0	Jan	+ 0.5	Jan	+ 4.7	Jan	+19.0	Q4	242.7	Jan
Thailand	+ 6.0	Q3	+ 3.9	Jan	+ 2.5	Feb	+ 0.2	Jan	+ 5.5	Jan	47.8	Jan
Argentina	+ 8.3	Q3	+ 4.9	Jan	+ 7.2	Jan	+12.3	Jan	+ 3.6	Q3	20.1	Jan
Brazil	+ 4.9	Q4	+ 8.3	Dec	+ 7.4	Jan	+35.1	Feb	+11.7	Jan	53.6	Jan
Chile	+ 6.8	Q3	+ 5.3	Jan	+ 2.2	Jan	+ 9.4	Jan	+ 1.4	Q4	15.6	Jan
Colombia	+ 2.4	Q3	+ 5.6	Nov	+ 5.3	Feb	+ 1.0	Nov	– 1.4	Q3	13.6	Jan
Mexico	+ 4.9	Q4	+ 3.9	Dec	+ 4.5	Jan	– 9.5	Jan	– 8.7	Q4	64.1	Dec
Peru	+ 9.1	Dec	+10.6	Dec	+ 1.7	Feb	+ 2.7	Dec	– 0.1	Q4	12.3	Jan
Venezuela	+11.2	Q4	+23.1	Nov	+16.9	Feb	+22.1	Q4	+14.6	Q4	18.2	Oct
Egypt	+ 4.7	Q4	+ 3.3	2004‡	+11.4	Dec	– 8.1	Q3	+ 4.1	Q3	13.8	Nov
Israel	+ 2.9	Q3	+ 4.4	Dec	+ 0.8	Jan	– 7.1	Jan	+ 0.5	Q3	27.1	Jan
South Africa	+ 4.7	Q4	+ 7.8	Dec	+ 3.0	Jan	– 2.4	Jan	– 4.7	Q3	13.4	Jan
Czech Republic	+ 3.6	Q3	+ 8.3	Dec	+ 1.7	Jan	– 0.8	Dec	– 6.4	Q3	27.8	Jan
Hungary	+ 3.7	Q4	– 1.4	Dec	+ 4.1	Jan	– 2.5	Q3	– 8.6	Q3	15.0	Jan
Poland	+ 4.8	Q3	+ 4.7	Jan	+ 4.0	Jan	– 6.1	Dec	– 3.6	Dec	39.6	Jan
Russia	+ 6.7	Q4	+ 2.1	Jan	+12.7	Jan	+91.1	Jan	+58.2	Q4	121.2	Jan
Turkey	+ 4.5	Q3	+ 4.7	Dec	+ 9.2	Jan	–34.5	Dec	–15.6	Dec	37.1	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.1	Q3	+ 5.0	Dec	+ 4.2	Jan	– 2.5	Dec	– 1.5	Q3	1.6	Nov
Latvia	+ 9.1	Q3	+ 6.0	Nov	+ 6.6	Jan	– 2.7	Nov	– 1.7	Nov	1.8	Nov
Lithuania	+ 6.4	Q4	na		+ 2.9	Jan	– 3.2	Nov	– 2.0	Q3	3.6	Nov
Slovakia	+ 5.3	Q3	+ 0.4	Dec	+ 3.2	Jan	– 1.4	Dec	– 0.9	Sep	13.4	Nov
Slovenia	+ 4.9	Q3	+ 6.3	Dec	+ 2.2	Jan	– 1.3	Dec	– 0.1	Dec	8.2	Oct
Pakistan	+ 6.4	2004‡	+12.1	Sep	+ 8.5	Jan	– 5.0	Dec	– 0.9	Q4	10.6	Jan
Saudi Arabia	+ 7.2	2003	na		+ 0.6	Nov	+59.1	2003	+28.0	2003	27.3	Dec

*Excluding gold, except Singapore; IMF definition. †New series ‡Year ending June, new series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Financial markets

Mar 3rd 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 2nd		Dec 31st 2004	
	Mar 2nd	year ago	Mar 2nd	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.8	4.98	1,351.3	– 1.7	+ 1.6	+ 1.6
Hong Kong	7.80	7.79	14.9	2.10	13,850.8	– 0.8	– 2.7	– 3.0
India	43.6	45.2	83.4	4.82	6,686.9	+ 1.6	+ 1.3	+ 0.9
Indonesia	9,284	8,563	17,733	7.56	1,082.7	– 1.8	+ 8.2	+ 8.2
Malaysia	3.80	3.80	7.26	2.82	891.9	– 0.9	– 1.7	– 1.7
Philippines	54.8	56.3	104.6	6.25	2,068.4	+ 1.3	+ 13.5	+ 16.3
Singapore	1.63	1.70	3.10	1.94	2,144.4	+ 0.4	+ 3.8	+ 4.2
South Korea	1,008	1,167	1,925	3.55	1,007.5	+ 4.0	+ 12.5	+ 15.5
Taiwan	30.8	33.2	58.7	1.35	6,225.3	+ 1.7	+ 1.4	+ 4.5
Thailand	38.3	39.5	73.3	2.53	720.9	– 1.3	+ 7.9	+ 9.3
Argentina	2.96	2.89	5.65	4.44	1,582.4	+ 4.0	+ 15.1	+ 15.7
Brazil	2.63	2.91	5.02	18.74	28,199.0	+ 3.7	+ 7.6	+ 8.7
Chile	588	609	1,123	2.88	9,246.5	+ 1.6	+ 3.2	– 2.4
Colombia	2,328	2,650	4,447	7.42	5,109.5	– 0.5	+ 17.6	+ 18.8
Mexico	11.1	11.0	21.2	9.33	13,770.3	+ 1.7	+ 6.6	+ 7.0
Peru	3.26	3.47	6.23	3.04	4,081.6	+ 0.8	+ 10.0	+ 10.6
Venezuela	2,667§	3,449§	5,095	12.04	30,650.8	+ 2.7	+ 2.3	– 1.1
Egypt	5.81	6.19	11.09	9.90	35,603.5	+ 9.0	+ 44.8	+ 51.4
Israel	4.33	4.49	8.28	1.00	675.8	+ 3.6	+ 5.0	+ 4.6
South Africa	5.92	6.76	11.3	7.60	13,456.9	+ 1.7	+ 6.3	+ 1.3
Czech Republic	22.6	27.2	43.1	2.18	1,211.3	+ 3.2	+ 17.4	+ 16.1
Hungary	184	210	352	7.82	17,782.8	+ 1.2	+ 20.6	+ 18.2
Poland	3.00	3.87	5.74	6.30	27,434.7	– 1.3	+ 3.0	+ 2.7
Russia	27.7	28.5	53.0	13.00	704.1‡	+ 4.6	+ 14.7	+ 14.6
Turkey	1.28	1.33	2.58	18.70	27,226.4	+ 1.1	+ 9.0	+ 9.0
EMF (MSCI)*	1.00	1.00	1.91	na	580.4	+ 1.6	+ 7.0	+ 7.0
EMBI+†	1.00	1.00	1.91	na	334.6	+ 0.1	+ 1.5	+ 1.5

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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